

CEOs dust off battle plans for new year

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Floods, penny-wise consumers, a roaring Australian dollar, booming commodity prices, heavy capital investment, labour shortages and fierce debates over regulation and new taxes were stacked against companies best-laid plans in 2011.

The net result will be zero growth in industrial company earnings for the financial year just passed, 50 per cent for resources companies and 13 per cent for the banks, broker forecasts say. The picture brightens a little for 2012 with earnings per share increases forecast at 19 per cent across listed companies and industrial company earnings resuming growth.

From an investors point of view its been a frustrating year of meagre returns and earnings disappointments for many of their preferred stocks. Some small resource stocks and the occasional biotech companies tripled and quadrupled in value.

But some bluechip portfolio staples like Leighton, Westfield, Bluescope, AMP and Telstra ended the year with their shareprice down and their outlook clouded.

As Colonial First State Global Asset Management portfolio manager Naz Ressas says, it's a vexed outlook for companies.

"There are basically three scenarios: a double-dip aka GFC mark 2; very short business cycles as everything is compressed as there is no follow-through beyond government or Reserve intervention; or you get a more traditional business cycle, where we move beyond stimulus and inventory restocking into a normal expansion and see real demand," Ressas says.

As most of corporate Australia ruled off its accounts, the *Weekend Financial Review* spoke to the chief executives of some of the country's biggest companies to gauge how they fared in 2010-11 and their expectations for the year ahead.

THE RETAILER

For Myer chief executive Bernie Brookes, 2011 was going to be the year the department store retailer took its place in the sun after four years of restructuring.

"We are out of the rebuild and we are into the growth stage," Brookes confidently predicted last August.

Instead, 2011 turned out to be the year Brookes – and many of his retail peers – would rather forget.

Myer shares started 2011 at \$3.16, reached a high of \$3.99 in September after a better than expected result and finished the year on its lows at \$2.64 after a series of disappointing sales figures and a profit downgrade. , the shares had hit a record low of \$2.63, 36 per cent below the price investors paid in Myer's 2009 float. The restructuring, including a spanking new flagship Melbourne store, won't be enough to stop Myer posting a fall in net profit of 5 per cent, rather than the 5 to 10 per cent growth forecast at the beginning of the year.

The entire discretionary retail sector was in the doldrums, with the sector's benchmark index falling 4.8 per cent. But Myer's shares fell 16.5 per cent, reflecting the level of shareholder disillusionment with the company's performance.



Bernie Brookes: When the \$A goes below parity many retailers will not be able to buffer.

Photo: Josh Robenstone

Much of this is outside Brookes's control. "Consumer spending has been impacted by interest rate rises, rising petrol and utility prices, rising education and healthcare costs, increased saving rates and a number of natural disasters, which all made retail quite difficult throughout the year," he says.

"In addition to that the flood tax and new carbon tax has also made consumers hesitant to spend, not to mention a fairly fragile political environment, (which) has not given them any confidence either."

Consumer confidence slumped to two-year lows and the household savings rate jumped to more than 10 per cent, a level not seen since 1986, forcing Myer and its rivals to slash costs and cut prices.

The high Australian dollar also had an impact. It made imported products cheaper, boosting gross margins and encouraging many retailers, including Myer, to set up buying offices in Asia to import directly rather than through third-party suppliers.

Shoppers, however, took the strong dollar as a cue to look seriously at shopping online from offshore e-tailers where they don't have to pay GST

"When the Australian dollar goes back below parity with the US dollar a lot of those benefits will be lost and many retailers will not be able to buffer the difficult consumer environment with money made out of the Australian dollar," he says.

Myer responded to the internet threat by setting up a Hong Kong-based e-commerce hub but its priority remains shop fronts, with plans to open 15 new stores over the next three years. , generating another \$450 million in sales.

THE MINER

Not too many things are going wrong inside a company if, after returning a substantial amount of capital to shareholders, it expects to quickly rebuild its cash position to where it was before.

Copper and goldminer OZ Minerals returned \$390 million to shareholders via a special dividend this year. By the time it completes a share buyback of up to \$200 million, it expects to be sitting on a cash pile of \$1 billion again, based on forecast profits from its Prominent Hill mine in outback South Australia.

Finding a new growth option remains the priority. Prominent Hill is the sole source of cash flow at the moment and, while it is operating smoothly, its reserves will only support production out to 2018.

OZ last year spent \$100 million on a 19.9 per cent stake in boom West Australian copper explorer Sandfire Resources (since diluted) and \$US250 million on the early stage Carapateena copper project in SA. But chief executive Terry Burgess says OZ is still looking for something to provide growth in the short to medium term, be it a new discovery in the Prominent Hill region or another acquisition.

"Obviously, we continue a very big campaign of exploration around Prominent Hill," Burgess says. "That's an area where we see we can add the most value for shareholders if we were successful in finding something.



Terry Burgess: We're going to start a flight directly out of Melbourne into Prominent Hill just to attract more people.

Photo: James Davies

"But on the M&A side, we're certainly out there looking for something that can bring us extra production in the sort of three- to four-year period to fill that gap between what we've got with Prominent Hill and Carapateena in the future."

While high copper and gold prices are generating lots of cash at Prominent Hill they are also making it hard

for OZ to find value in acquisitions

Burgess believes this situation should persist into next year and beyond, particularly in regards to copper.

"We certainly see that supply remains very tight," he says. "We continually see underperformance from a lot of operations around the world that are already at maximum production, so despite the poor macro conditions we've seen, we're going to have a robust copper price going forward.

"On the demand side we don't see any change. We continue to see interest coming out of China, India and other developing economies for copper, and there's no reason in our view why that should change in the near future."

Unlike coal and iron ore miners, OZ does not face a threat from the minerals resource rent tax, but there are other pressures such as labour shortages, building.

"From our point of view, we're pushing an advertising campaign at the moment to try and get more people, to be more competitive, to look at resourcing people out of different places," he says. "For example, we're going to start a flight directly out of Melbourne into Prominent Hill in the coming weeks just to attract more people."

THE BANKER

Westpac Banking Corp chief executive Gail Kelly started the year being named the world's eighth-most influential woman and ended it trying to navigate the bank through a period of weak demand for loans. In between, the chief executive of Australia's second-largest bank delivered a record profit, was forced to douse speculation about her own future and strongly criticised the wave of international and domestic regulation being thrust upon the banking industry.

Westpac's share price tracked sideways for most of the year, finishing up 4.85 per cent. But it was a case of back to the future for strategy as Kelly resurrected the Bank of Melbourne name that it had buried.

It's part of a multi-brand strategy that aims to forge deeper relationships with affluent, SME and commercial customers.



Gail Kelly: Some of the regulation comes from other countries that has absolutely no benefit for us.

Photo: Michel O'Sullivan

"We're at early stages for multi-brand but I'm really happy with where we are," she says.

The bank is tracking well in its preferred measure of customer satisfaction, "net promoter scores", across its target markets.

"We're number one in a number of those relative to the major banks," she says.

Kelly delivered Westpac's biggest ever annual profit last year, rounding out a bumper year of record earnings for the major lenders.

Despite the financial success, Kelly, who rated number 8 on Forbes magazine's list of the 100 most influential women in the world last October, has been confronted with a throng of professional challenges.

Shortly after unveiling a 26 per cent increase in cash profit to \$5.9 billion for the year to September 30, Kelly, along with other bank bosses, drew the scorn of politicians for lifting rates by more than the Reserve Bank of Australia's quarter of a percentage point in November.

A month later Treasurer Wayne Swan unveiled a bank reform package that included bans on mortgage exit fees and price signalling, responsible lending laws, funds management changes and an overhaul of credit

card rules.

"There's quite a load that bank management, bank boards and regulators have to take on board over the next period and some of it is unfortunately regulation that comes from other countries that has absolutely no benefit for us whatsoever but it's going to put a load on us," Kelly says

Internationally there is the United States Dodd-Frank laws, the imposition of a central clearing house for over-the-counter derivatives, Basel III capital and liquidity rules and the US Foreign Account Tax Compliance Act (FATCA) that will add "tens of millions" of dollars to Westpac's expenses.

Westpac, Australia's second biggest home lender, along with the other major is grappling with weak loan demand, as households and businesses continue to deleverage and act with caution.

Consumers repaying debts and saving eased the task of funding bank balance sheets but it has meant weak lending growth. To deal with softer revenues, Westpac is focusing on containing costs.

"The other side of the equation is productivity – simplification and streamlining our business," she says.

THE REALTOR

GPT chief executive Michael Cameron hopes 2012 will be the year the diversified property group makes good on all the change he has overseen in the past two years.

Since taking the helm in 2009 Cameron has sold GPT's non-core assets, including hotels, retirement villages and offshore properties, leaving the company a largely domestic-focused office, retail and industrial landlord.

Profits have followed: from a \$3.2 billion net loss in 2008, GPT moved to a \$1.07 billion loss in 2009, a \$707.3 million profit in 2010 and a hoped-for improvement this year.

A troubling 12 per cent gap between net tangible assets and the share price remains and the challenge for Cameron is to close it.

The company is pursuing a buyback of 5 per cent following on from a five-for-one share consolidation in 2010.

After GPT, and the listed property sector in general, were ravaged by the global financial crisis, which saw asset values fall and credit markets virtually close, Mr Cameron took the helm at GPT in early 2009.

How quickly the gap narrows depends largely on the strength of physical property markets in the coming year, as well as a recovery in investor sentiment.

The office sector is showing signs of strength as corporate tenants resume growth plans that were shelved in the global financial crisis.



Michael Cameron: We expect the prime office markets to continue to strengthen.

Photo: Andrew Quilty

"We expect Australia's prime office markets to continue to strengthen for the remainder of the year. With increasing white-collar demand, constrained supply, and reducing vacancies, we expect this to lead to solid rental and capital growth," Cameron says.

Weaker consumer sentiment weighs on retail landlords, but Cameron sees that the domestic economy is starting to improve.

In the past week, Westpac confirmed it would send as many as 100 jobs overseas, ending a two-year moratorium on offshore outsourcing.

As well as dealing with low credit growth, more regulation and competition from a resurgent Cameron Clyne-led National Australia Bank, in January an unverified media report suggested Kelly's job was under review. Chairman Ted Evans and Kelly refuted the claim. Kelly told the Financial Review at the bank's half-year result in May, she's not going anywhere.

"I think you can see ... I do enjoy it," she says, with her trade-mark beaming smile.

"It's a very challenging job and a full job and a job that is immensely interesting."

In the year ahead, Westpac's incoming chairman Lindsay Maxsted will take over this December.

"Lindsay is fabulous," Kelly says.

"He started virtually at the same time I did in early 2008.

"He has been on the same page and part and parcel of the board signing off on the strategy we are pursuing now."

Kelly says the bank will continue to focus predominantly on domestic growth, via its multibrands, Westpac, St George Bank, BankSA and the soon to be re-launched Bank of Melbourne, which will open in August.

But across the major companies delivered three figure mall - even among some of the better established Investors are hoping all the bad news is priced in to stocks right now and the sharemarket can build on the small gains posted in the past financial year.

But/despite stocks got off to a good/bad start on Friday when they rose/fell but after a lacklustre 12 months that saw the major S&P ASX index gain xx per cent, market watchers are expecting another volatile year, even though heavily depressed valuations might provide some relief.

Colonial First State Global Asset Management portfolio manager Naz Ressas said that everything seems to be placed in two buckets right now, either there's inflation and growth and resource stocks go for a run or there's fear and loathing and the defensive stocks outperform.

"There seems to be limited focus on the underlying economics of companies through the cycle which throws up opportunities for active managers," he says.

"There are basically three scenarios; a double dip aka GFC mark 2, very short business cycles as everything is compressed as there is no follow through beyond government or reserve intervention, or you get a more traditional business cycle where we move beyond stimulus and inventory restocking into a normal expansion and see real demand. Under the first two scenarios people would avoid equities and question valuations later," he warned.

The benchmark index has managed to post gains for two consecutive financial years but over the past month earnings forecasts have been downgraded for more than half of the companies that make up the major index compared to only 56 upgrades.

Despite the downgrades there has been little change to earnings forecasts.

Consensus forecasts shows that market watchers are expecting earnings per share growth of 17 per cent for financial year 2011, although much depends upon the resources sector delivering growth of more than 50 per cent. The industrial sector is forecast to deliver no growth, with EPS estimated to rise by 13 per cent in the bank sector. In 2012 EPS growth is forecast to rise 19 per cent with growth of 33 per cent coming from the resources sector and 17 per cent in the industrial sector.

Wilson Asset Management portfolio manager Matthew Kidman warns that despite attractive valuations, in particular in the industrial sector, the poor state of the local economy, outside the resources sector implies that shares will struggle to make any meaningful gains in the next six months or so.

"You're going to have your up days but they will be followed by the odd down day too meaning it's going to be a struggle to make any meaningful gains. The companies we talk to have indicated that trading conditions have got worse over the past eight weeks or so and really to get things moving you need the RBA to cut rates but they seem to be focused on the resources boom and want to raise rates," said Kidman.

He adds the key to the outlook for shares remains China and how they manage any inflation and slowdown issues but also the US economy that is struggling to post any sort of meaningful growth despite the enormous amount of stimulus that has been implemented.

Despite the modest return over the past 12 months there has been a number of stocks that have made spectacular gains. Bathurst Resources heads the list with a 5xx per cent return, but other standouts include Mesoblast, up 3xx per cent, Aurora Oil and Gas, up 3xx per cent and Iluka Resources up 2xxper cent. At the other end some of the worst performers include Energy Resources Australia, down 70 per cent, Murchison

Metals down xx per cent, Infigen Energy down xx per cent and Gunns down xx per cent.

Some of the best performing sectors were materials, up 10 per cent, utilities up 6 per cent, and industrials up xx per cent.

Discretionary spending was hit by the rising Australian dollar and the charge to shopping on the internet and the consumer discretionary sector was down xx per cent while consumer staples backed up their defensive nature with a small gain of xx per cent.

Investors have had a host of issues to contend with in the past 12 months including concerns about a possible default by Greece on its debt obligations, a slowdown in the US, uncertainty about inflation in China a high Australian dollar and the prospect of higher interest rates.

These events have conspired to push shares down sharply since the April highs with some managers hopeful of a bounce to relieve oversold conditions that might be helped by improving news regarding Greece. Valuations are attractive with the market trading on a 12 month price earnings ratio of around 11.5 times earnings ,well below it's long term average of around 14.5 times.

However, further weakness in the next few months is still on the cards as worries persist about the global economic outlook and stocks have been cheaper falling to a PE of around 8.5 times in early 2009 when the global financial crisis was in full swing.

He plans to meet the challenge of online retailers by improving consumers' experiences in its malls.

"GPT's strategy around this is to focus on quality regional centres where retailers will continue to demand a physical presence, create great places for communities to embrace and evolving the retail mix to meet changes in consumer spending habits," Cameron says.

The collapse of retail chains such as REDGroup and Colorado also put investors on alert but Cameron says there is demand from other tenants to take up the empty space.

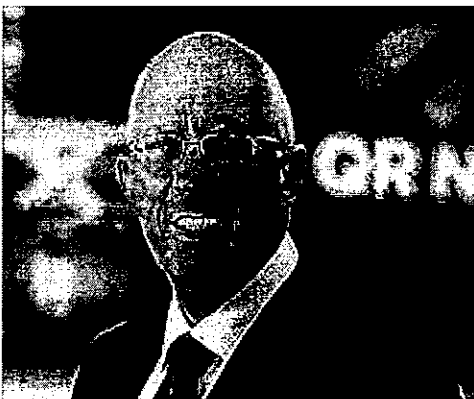
THE RAILWAYMAN

QR National's first seven months as a publicly listed company have been unexpectedly tough, with the damage to coalmines from the Queensland floods reducing profits from its coal haulage operations.

The railroad group has remained in favour with investors, in part because it has been able to generate more cost savings than expected by cutting jobs and making its operations more efficient. Its exposure to the resources industry has it ideally placed to take advantage of demand for Australian commodities from Asia.

Although recent economic data suggest China's manufacturing operations may be slowing down, QR National chief executive Lance Hockridge is "bullish" on Asian demand for Australian coal.

QR National's biggest challenges are at home, where Hockridge acknowledges his company must "compete hard" for contracts with its "high quality" competitor in Asciano. "We'd be nuts not to expect that will be the case ... Both players have to be sharp."



Lance Hockridge: I am not too worried about the carbon tax. It will be of more concern to our customers.

Photo: Glenn Hunt

With its biggest customer, the BHP Mitsubishi Alliance, due to renew its contracts with QR National in 2014-2016, the haulier is improving the quality of its service, moving to more flexible contracts, promoting "cultural change" internally that includes the establishment of a "transformation office" as it tries to shed the bureaucratic mores it inherited from the government, and running a series of voluntary redundancy programs.

"Internally you can't imagine a greater change," Hockridge says. It is also trying to improve its loss-making Intermodal freight business in Western Australia. The CEO's biggest concerns for 2012 are the weather – coal customers are still not back at full capacity after the floods, another unusually rainy summer would further hurt QR National's profits – and maintaining the stability of its share register, which has attracted a lot of hedge funds.

QR National's shares have performed better than expected since its \$6.2 billion float in November, rising as high as \$3.59.

But selling by some of its overseas investors over the past month as some take profits and others take a more bearish view on Asia's economic outlook has underscored the need to have a stable group of long-term domestic shareholders. Some investors also remain reluctant to hold QR National shares before the Queensland government, which owns 34 percent of its stock, sells its holdings.

Some analysts have called on QR National to consider a share buyback to acquire all or most of the Queensland government's shares. This would increase the company's gearing to around 50 percent, according to the Commonwealth Bank, but lower its cost of capital. Hockridge claims not to be too worried about the prospect of the carbon tax, arguing it will be of more concern to its customers with QR National having held its emissions stable for many years. "We've deliberately chosen not to be an active participant [in the debate]".

THE MEDIA MAN

The spate of profit warnings and downgrades earlier this year told the story: times are tough in the media sector.

After stronger than expected growth in advertising revenue – the main source of revenue for most media companies – during 2010 and into early 2011, the industry hit a rough patch in February and has seen ad markets become progressively tighter since then.

The profit warnings from companies such as Fairfax Media (the publisher of the *Weekend Financial Review*), Ten Network, Seven West Media and APN News & Media reflected the shaky state of media ad spending and – in some cases – the impact of the Queensland and Victorian floods and the Christchurch earthquake.

"It hasn't been an easy six months," says Brett Chenoweth, who joined the trans-Tasman APN News and Media newspaper, radio and outdoor advertising group on January 1 as chief executive. "The contraction of the Australian economy in the first quarter of this year had a direct impact on media companies, as marketers in many areas reined in their spending. There's no end in sight to that; the economy looks pretty patchy for the next quarter or so."



Brett Chenoweth: Newspapers are still a big, strong business.

Photo: Michele Mossop

Anxiety about the state of media ad markets has pushed down the share prices of most media companies over the past year. Some have ignored the trend: the relentless growth of online ad markets has lifted REA Group and Carsales.com, while shares in regional pay television operator Austar United Communications rose ahead of a takeover offer from its capital-city counterpart Foxtel.

APN was one of the worst-performing media stocks in 2010-11, sagging about 34 per cent. Chenoweth says the decline was not surprising, given the state of the Australian and New Zealand economies, the recent natural disasters and investors' concerns about how APN will be affected by the spread of digital media.

"The growth of digital media is not, of course, a new trend, but it's again been a major issue in the media sector over the past year. These days, everything in media has to be seen through a digital lens.

"As a media executive, you have to keep thinking about digital all the time."

According to Chenoweth, the noise surrounding digital media – be it Google's latest crack at the social media sector or the eye-popping market capitalisation of business networking site LinkedIn after it floated in the United States – is hurting perceptions of "old" media companies.

"The noise means people are spending a disproportionate amount of time thinking and talking about things like social media sites and group buying sites. Yes, the time people spend with digital media is growing, but it still needs to be kept in context. Newspapers, for example, are still a big, strong business."

THE GAMBLER

Larry Mullin, chief executive officer of the newest member of the ASX 100 – Echo Entertainment Group – says the 2011 financial year cemented in his mind why the company needs to change its customer base, and soon.

While Echo's Star City casino in Sydney managed to increase revenue despite being a construction site, the property's old clientele are the same group being hit by consumer unease and spending restraint.

Mullin has been busy trying to keep that old customer base in tact until his \$960 million renovation at Star City is complete, with investors keeping an eye on the company's trading throughout the process.

"We have to change the demographic of this place. The customer we're going after has a bit of a wider spread to their wallet – they're not so price sensitive," Mullin says.

"The challenge we faced was meeting the forecasts we'd set in a construction site and the market marking our paper as we went along. If I could have undone anything I probably would have not been as specific [with forecasts], because you just don't know what will come."



Larry Mullin: The customer we're going after has a bit of a wider spread to their wallet.

Photo: Dallas Kilponen

Echo has been meeting its financial targets so far, and investors are increasingly warming to the potential growth story at Star City and in Queensland when the company's casinos there get their facelift.

Along with cautious consumers, uncertainty over the economy and a minority government pursuing Andrew Wilkie's anti-pokies agenda hasn't helped, the Echo CEO says.

"The government has taken this up for political reasons, and managing that risk is a big part of the job. It will affect tourism if he [Wilkie] has his say. We will be as active as we need to be as an industry to make sure what we're saying is heard," Mullin says

However the Echo CEO says his biggest challenge has been getting his staff to believe Star City could be a world-class casino. "It was getting people to say 'I absolutely believe this can be something that other people are saying it can't be'. It's transforming a mindset about what people think of us today and what we want them to think of us in the future – the time frame we can do it in is the bet."

For the year ahead, Mullin says his biggest worry is that "a global event" will spook financial markets even more which would see tourism drop off.

THE GASMAN

Origin Energy's \$3.25 billion NSW power acquisitions were transformational in 2011 and managing director Grant King has another big year ahead with the targeted go-ahead for a huge liquefied natural gas project.

The events have placed Origin in the market spotlight over the past for huge capital raisings but also landed

them in the middle of several broader debates, such as the carbon tax, that stand to deeply affect Origin's business.

Top of the list is the government's carbon pricing plan.

"There is a lot of noise in the system at the moment because we've got a very active and frankly divisive debate in the community about the pricing of carbon," King says "Energy is front and centre of that issue."

The fall-out from the wrangling includes the impact on public perceptions about increases in household power bills, on the ability to commit to supply contracts and the effectiveness of forward markets, he said.



Grant King: I am more concerned about why costs are escalating.

Photo: Louie Douvis

Origin has long argued in favour of carbon trading as the most cost-effective way to reduce greenhouse gases.

But the public's increasing awareness of higher electricity prices and confusion about what is driving the increases is muddying the discussion.

The price increases are being driven primarily by investment in networks, with a contribution from renewable energy schemes such as state-based solar incentives, but that is not always clearly portrayed, Mr King said.

As an energy retailer with no presence in transmission and distribution, Origin is not directly contributing to the increases, but as the bearer of the news to customers, suffers from the effects.

"Because we are in quite a divisive debate many of these points are being linked together in convenient but not always appropriate ways," he says.

The pick-up in competition between NSW retailers post the \$5.3 billion power privatisation has raised the tensions. AGL Energy is aiming to add up to 500,000 accounts in the next three years, primarily by poaching them from its two rivals - Origin and TRUenergy - that paid up for the government retailers.

The companies will report on their customer numbers in their August earnings releases.

The increases in power prices are feeding public perceptions that a privatised industry inevitably leads to higher charges.

But Mr King says that privatisations have just led to "more appropriate" pricing to ensure long-term investment in supply after past periods of under-investment.

He expresses frustration at the "quick and easy solutions" such as solar schemes that were introduced just a few years ago and have cost more than some people thought.

"We have been subject as an industry to solutions that have not been well designed and have not necessarily been fact based or knowledgably based on how the industry operates," he said.

Origin's Australia-Pacific LNG project with ConocoPhillips, slated for a final investment decision by the year-end, is among a crowd of LNG megaprojects under development that are benefiting from a brighter demand outlook for gas in Asia, partly driven by the Japanese nuclear disaster.

The venture has signed up China's Sinopec as its first major customer and is in advanced talks with others.

Mr King refers to the "significant transformation in prospects" for LNG over the past year.

"It's almost bizarre to look back at things people were saying a year ago through today's eyes," he said.

The APLNG project, to start production in 2015, puts Origin in the thick of mounting concerns about spiralling capital and labour costs for resources projects.

King says he is more concerned about why costs are escalating, pointing to cultural and institutional issues that come into play from permitting a project through to construction that make it challenging to deliver plants on time and budget.

"As a country we will be challenged to do that and we will be forced to revisit a lot of those institutional arrangements if we are going to get it right," he says.

Philip Baker

The Australian Financial Review

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