Harbour Navigator

On the road in Australia

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Over the first week of May the Harbour equity research team met with more than 30 Australian companies.

We learnt that the Australian economy is still in a significant period of transition, with some sectors such as technology doing extremely well and others such as consumer discretionary and staples retailing under pressure.

There is some negative tail risk for Australian sectors exposed to the residual impact of the slowdown in mining activity. Companies which form part of the resources supply chain, not only mining services contractors, face risk from the resource sector cutting costs. Some companies in the development and construction industry are under pressure where management have over committed and face problems delivering on those commitments.

We also learnt that regions of Australia leveraged to mining activity have stabilised and may have adjusted to a lower base of activity levels.

Residential activity is cooling in areas where new development exceeds underlying demand. Apartment prices are under pressure in Melbourne and Brisbane where new supply now exceeds natural demand. Relative to population growth, Sydney remains undersupplied, but affordability is low, capping price appreciation potential. In general, the pace of price increases and general activity in Australian residential property is set to slow. This is a good thing – the various cooling measures put in place by a range of Australian regulatory bodies is reducing the risks of a residential property asset 'bubble' implosion in Australia.

Our company meetings confirmed that revenue growth is modest, but so is cost growth. So while there is near-term risk to earnings as the economy continues to transition, our research suggests a base is forming in Australian equity market earnings. Such a basing in earnings expectations may represent an important turning point for sentiment towards the Australian equity market.

Structural industry change is testing some Australian company models. The challenge is not restricted to smaller companies, with many large duopoly and oligopoly structures, that the Australian economy is well known for, under pressure from rapid industry change. This is creating a ripe environment for consolidation in sectors such as aged care, retail and business services. But there will be winners and losers out of this process, and we remain vigilant to companies and investors overpaying for synergy potential from consolidation.

In summary, our latest round of Australian meetings confirmed that there are selective quality investment opportunities in Australia. In some cases the market may be discounting Australian stocks for macroeconomic 'Australia Incorporated' risk and missing strong company specific opportunities.

Shane Solly, Director, at Harbour Asset Management

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