Daiwa SB Investments

Views from the Japan Equities Small Cap Desk

Earnings are above expectations

14 May 2019

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INTERVIEWED FEATURED IN THE NIKKEI - ARTICLE [14/05/2019]

"Earnings announcements started amid a stock price decline, but results for the FY2018 are not as bad as I had expected."

A day in the life during earnings season

Earnings announcements are now in full swing. Earning seasons usually means having my hands full after 15:00 with looking through earnings reports released by companies while having little time to spare in the daytime. I often find a few worse-than-expected results in my investments. It is highly stressful, but one cannot get away from it as a portfolio manager. When the earnings season runs its course, I become busy with interviews during the day, as corporate managers and investor relations (IR) personnel start visiting their shareholders individually.

How are the financial results for the FY2018 and FY2019?

The stock market declined sharply due to resurgent trade tensions following an abrupt comment on Twitter by US President Donald Trump. As the latest earnings season happened to coincide with this uncertainty, I was slightly wary about the overall performance at first.

The economy started to decelerate rapidly across the world, particularly in China, from the latter half of FY2018, and I was unable to ascertain its impact on the Japanese stock market. However, I do believe that the results for FY2018 and the forecasts for FY2019 are "not as bad as I had expected" as at 10 May when I wrote this column.

While I was worried about sharp successive slowdowns for the January-March quarter of FY2018, not as many companies seem to have experienced worse-than-expected declines in performance. With regard to forecasts for FY2019, companies' guidance has been mixed so far with "earnings growths and declines on halves," which falls below analyst consensus. Nonetheless, the consensus lags behind both corporate performance and stock prices. I am not unduly disappointed. I would rather examine whether the economic assumptions of each company is appropriate or not.

A series of announcements on dividend increase

Strong earnings stand out in the construction sector. An improvement in order situations seems to not only offset wage increases and price hikes in materials but pushed up the earnings as well. Upbeat results are likely to continue into FY2019 thanks to special demands ahead of the Tokyo Olympics and major orders for high-rise office buildings. That being said, it is difficult to estimate stock prices as performance is likely to peak out at that point.

Companies appear to be positive about dividend increase, with some announcing plans to increase dividends at the beginning of the new financial year despite weak guidance. The prevailing view for most Japanese companies is that further fattening of internal reserves is not necessary given their already high capital ratios combined with low business risks and low growth potential. I see a series of dividend increases as a favourable trend.

It appears that the market appreciated companies that increased dividends in its own way even in the latest stock price fall. I feel that the market is tilting too much toward shareholder returns in evaluating each issue, but if Japanese companies continue to accelerate the streamlining of their balance sheets, not only will investors but also our society as a whole can enjoy the benefits.

Source: Article by Tatsuro Nigauri, featured in The Nikkei, on 14 May 2019

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