

Box C: Recent Corporate Profit Warnings

As discussed in the May *Statement*,¹ profits of listed companies have increased strongly in recent years. Profit growth was particularly strong in the first half of 2004/05, with listed companies' aggregate underlying profits being 33 per cent higher than in the corresponding period of the previous year. This compares with average annual growth in underlying profits of 11 per cent since 1997.

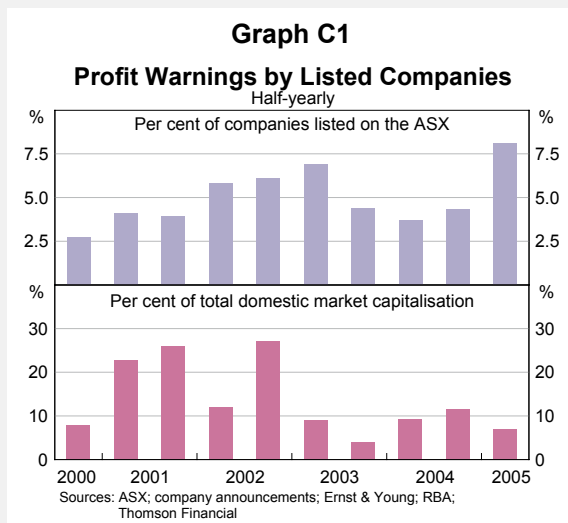


Table C1: Reasons for Profit Warnings

Per cent of companies giving warnings
in January–June 2005^(a)

Reason	Per cent
Company-specific issues	59
Tougher trading conditions	44
<i>of which related to weaker residential construction</i>	9
Adverse currency movements	16
Higher cost of raw materials	14
Weather conditions	8
Higher fuel costs	8
Labour shortages/higher wages	5

(a) Some companies cited multiple reasons.
Sources: company announcements; RBA

be considered company-specific (such as write-offs of capital expenditure, restructuring costs, staff redundancies, the loss of a major customer or contract to a competitor, and interruptions in production or distribution) (Table C1). The next most commonly cited reason was difficult trading conditions, in some cases driven by weaker residential construction activity.

In the first six months of 2005, 130 listed companies issued warnings that profits in 2004/05 as a whole would most likely be less than previously expected. (There have also been a few warnings made since then.) This is around 8 per cent of all companies listed on the Australian Stock Exchange, a share which is quite high by recent historical standards (top panel of Graph C1). Part of the increase in the number of companies issuing warnings is probably a result of increased pressure to improve transparency and provide fairly explicit earnings forecasts to the general public. It is also perhaps an attempt by companies to rein in expectations of a continuation of the recent very strong pace of profit growth. Moreover, the companies that have issued profit warnings tend to have been small. As a result, they comprise around 7 per cent of total market capitalisation, which is not high by recent historical standards (bottom panel of Graph C1).

Of companies giving warnings, 59 per cent cited factors which could

¹ See 'Box D: December Half 2004 Profit Results', Statement on Monetary Policy, May 2005, pp 54–55.

Of companies issuing warnings for the 2004/05 financial year, almost two thirds by number (79 out of 130) and 40 per cent by market capitalisation expect negative earnings growth – that is, a lower level of earnings (Table C2). The remaining companies are expecting positive, but lower-than-initially forecast, growth in earnings in 2004/05. Many of these will probably still report strong earnings growth, with aggregate earnings for these companies expected to be almost 23 per cent higher than in 2003/04, virtually the same as the growth rate for the broader market. This suggests many of the profit warnings were merely a scaling back of extremely strong expectations.

As noted above, the profit downgrades were concentrated amongst companies that tended to be a bit smaller than average. As well, some companies have indicated that profits will be stronger than previously expected. Reflecting this, forecasts for growth in aggregate earnings in 2004/05 have been revised down only slightly in the last couple of months, to around 22 per cent for companies in the ASX 200. Growth in 2005/06 is expected to be around 15 per cent. ¶

Table C2: Earnings Outlook

	Number of companies	Per cent of market capitalisation ^(b)	Earnings ^(a)	
			Full year 2004/05 \$b	Growth since 2003/04 Per cent
Companies issuing warnings in January–June 2005:				
Negative earnings growth	79	2.6	1.51	–28
Lower earnings growth	51	4.3	2.30	23
ASX 200	200	82.5	47.95	22

(a) Includes companies that made losses in either financial year. Excludes companies that did not provide quantitative guidance.

(b) As at 30 June 2005.

Sources: ASX; company announcements; Ernst & Young; RBA; Thomson Financial