



A Franklin Templeton Company

# Australian Reporting Season Wrap

## Protecting the 'castle' in the AI era: Competitive moats and earnings risk in Australia

Recent shifts in interest rates and renewed inflation pressures have sharpened the market's focus on the durability of company earnings. Against this backdrop, wide valuation dispersion across Australian equities continues to create an attractive environment for active stock selection, particularly where earnings moats are being tested or reinforced.

Reporting seasons offer a timely window into how companies are navigating these challenges. Through results, guidance and direct engagement with management teams, the ClearBridge Australian Equities team has been assessing the resilience of earnings moats, including how emerging technologies such as AI may strengthen competitive advantages for asset-heavy or process-driven companies while exposing vulnerabilities in more service-oriented business models.

In our reporting season wrap, we share our key insights, earnings signals from company results and meetings, and where the team sees the most compelling valuation opportunities as we look toward 2026.

## Key Takeaways

- **Strong earnings outcomes, but limited upgrades**  
Earnings, dividends and revenue broadly met or exceeded expectations, reflecting improved economic conditions. However, revisions remained muted as companies and analysts tempered optimism with macro and consumer-related uncertainties.
- **Elevated price dispersion despite modest revisions**  
Share price reactions were extreme relative to the underlying earnings changes, particularly among large caps. Tight liquidity and index flows continue to amplify market moves, with winners and losers seeing outsized divergence.
- **Broad-based growth, led by financials and cyclicals**  
Earnings growth has accelerated across most sectors, with banks benefiting from strong credit growth and limited margin pressure, and resources supported by higher commodity prices and improving global demand.
- **AI reshaping competitive moats unevenly**  
AI is emerging as both a tailwind and a threat. Incumbent, asset-heavy businesses are already realising productivity gains, while software and service models face competitive pressure.

- Valuations resetting, dispersion remains wide**  
 Software stocks have begun to de-rate as long-term earnings assumptions are reassessed, yet the valuation gap between expensive and cheap stocks remains historically elevated.
- Implications for investors**  
 In a market defined by structural change, macro uncertainty and heightened dispersion, a disciplined, risk-aware approach is critical.

**Analytical Review of Results and Revisions**

**Economic strength seen in 'beats', but lack of upgrades despite guidance**

Across our S&P/ASX 200 stocks universe, the level of surprise was the best we have seen since August 2023. This summary measure of the aggregate of actual results compared to pre-reporting broker consensus forecasts saw a positive skew on earnings per share (EPS), a positive skew on dividends per share (DPS), and in-line revenue or sales per share (SPS) (Exhibit 1). This reflects the strength of the economy, as business conditions and consumer confidence have materially improved over the last six months.

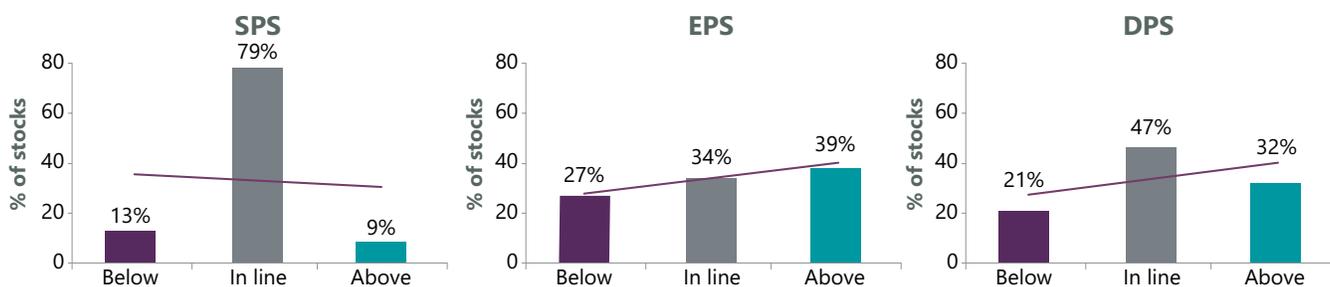
Names beating expectations included Northern Star, BlueScope Steel, Aurizon Holdings, Tabcorp Holdings and Telstra Group. Conversely, Wesfarmers, CSL, Seek, Dexus and REA Group were weak.

Despite the generally positive results, changes to broker consensus forecasts for earnings after the release of results have been subdued. Exhibit 2 shows a balance between upgrades and downgrades across the P&L metrics. This was despite guidance, from the 25% of companies that provide the information at this time of year, being predominantly positive. Forward-looking prospect of higher rates, concerns about inflation's impact on real wages, and fears of consumer belt-tightening were the main constraints on earnings revisions.

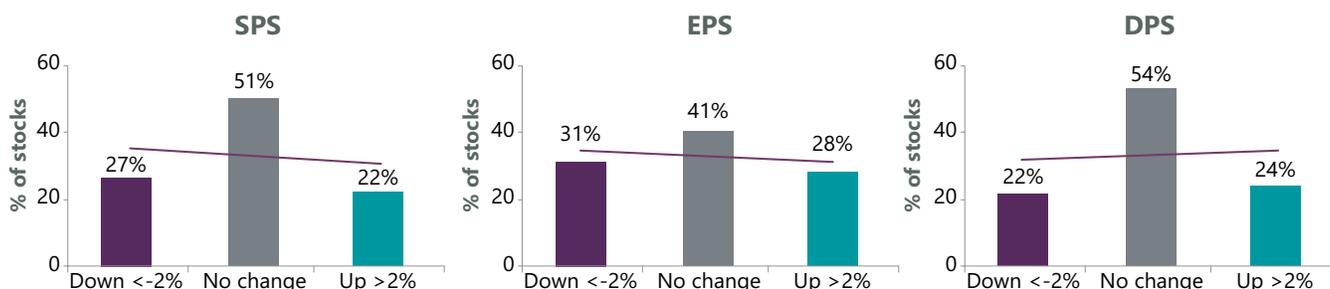
Management discussions reflected this sentiment. Wesfarmers described conditions as resembling the post-Covid era, when wage pressure existed. Nine Entertainment described people as anxious about geopolitical risks but also looking for escapism.

It's important to remember that results and reactions for this reporting season were prior to the Iran war breakout. Some of the bigger upgrades were amongst the banks like National Australia Bank and Commonwealth Bank of Australia. QBE Insurance Group also had good revisions, as did miners like BHP Group and resource-related stocks Aurizon Holdings and AGL Energy. On the negative side was energy. Santos and Ampol had negative revisions, obviously before the oil price surges. Other key negatives were in healthcare stocks like CSL.

**Exhibit 1: Surprise (Percent of S&P/ASX 200 Companies Reporting)**



**Exhibit 2: Revisions (Percent of S&P/ASX 200 Companies Revised)**



### Hot, Hot, Hot!

Banks' credit growth has accelerated over the last 12 months, and as they have had limited margin contraction, they have been able to benefit more than normal (Exhibit 3). This has been the epicentre of market strength. Credit growth is a product of lower recent interest rates, first home-owners grants and good business credit growth. The high levels of credit growth are likely a key driver for the RBA's cash rate determinations, even before the Iran situation compounded things.

Looking at profit growth for the broader market in Exhibit 4, revenue growth has accelerated to nearly all segments, and expected EPS growth is now in the double-digit territory. This is very similar to the positive post-Covid bounce we saw in 2021.

On a global basis, Australia had previously lagged other bourses with respect to earnings growth but has turned the tables this reporting season. While this is largely due to commodity prices and resource earnings improvement, we are now seeing genuine breadth in improvement into the diversified financials, and the industrial space, where companies are benefiting from a strong GDP growth environment, allowing them to get margin expansion via cost control (Exhibit 5).

Exhibit 3: Credit and Growth Rates

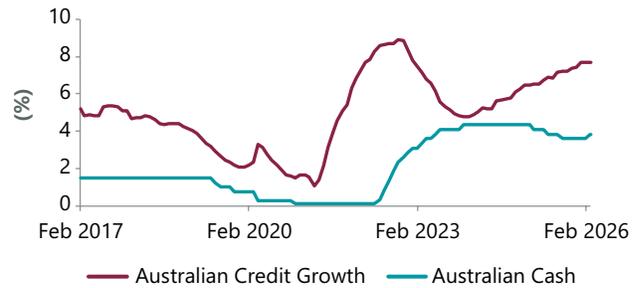
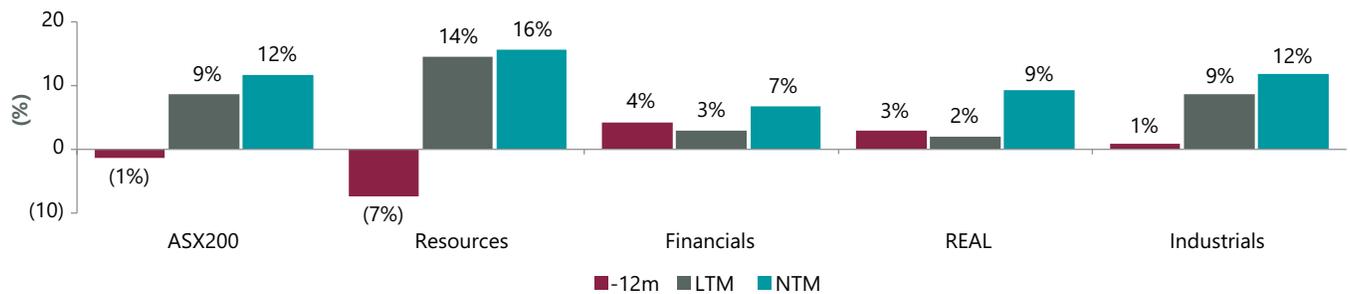


Exhibit 4: Sales and Earnings Growth (NTM vs. LTM)



Exhibit 5: Profit Growth Forecasts vs. Prior Year results



### Unpacking the reaction

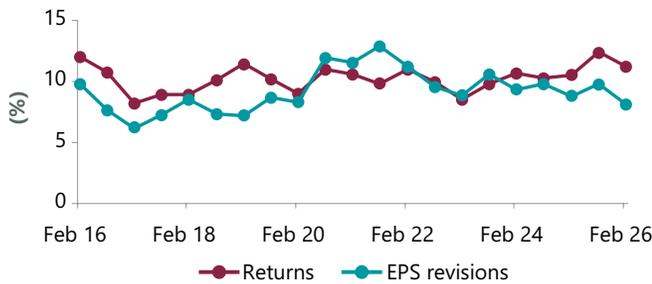
#### Large cap volatility and few winners

Results and revisions are one thing, but the other part of the reporting season equation is how the market reacted to them with share prices changes.

In Exhibits 6 and 7 we show the variance in EPS revisions (upgrades versus downgrades) during each reporting season month and compare this to the variance in share price reaction.

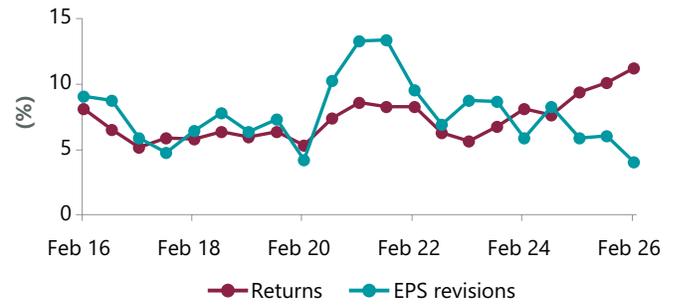
For the broader S&P/ASX 200, EPS variance was relatively low compared to recent history, and not particularly different across industries and sectors.

Exhibit 6: Cross-sectional variance – S&P/ASX 200



For the top 50 names we did see an almost record low in EPS revision variance. However, share price reaction was markedly different, especially for the S&P/ASX top 50 names.

Exhibit 7: Cross-sectional variance – S&P/ASX 50

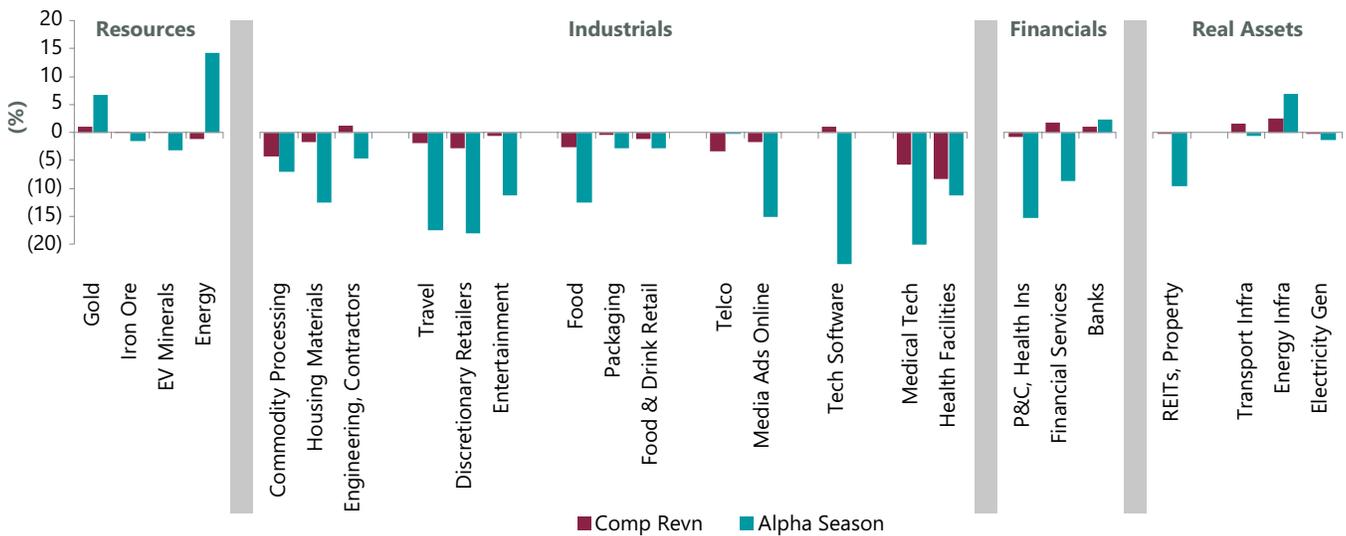


In many cases, prices of the winners were up more than 20%, whereas the losers suffered declines more than 30%. This is surprisingly large dispersion in price reactions given the quite mild EPS revisions.

It continues a theme we have been noticing over the past few reporting seasons wraps. The liquidity, or the volume of shares traded, in the S&P/ASX top 20 names is generally falling as we see more and more passive indexed money, creating very tight liquidity conditions at the point when new information is released (such as in reporting season).

The negative scale of the share price reaction is stark on our equal-weighted chart in Exhibit 8. For the full reporting season month of February, the S&P/ASX 200 Accumulation Index rose 4.1% in aggregate. But the top 20 stocks in the market delivered a 7% positive return, whereas the rest of the market, the equal weighted 200 index, was down 2%. So that's a 9% spread between the median and the S&P/ASX top 20 names.

Exhibit 8: Results scorecard: by industry group (S&P/ASX 200 equal weighted index)



### Risks to manage over last year

These price impacts have also had a large impact on the constituents of the index, as can be seen in Exhibit 9 below.

- CSL underperformed 50% and its starting index weight was 6% of the index, falling as low as 2.5% during the period.
- BHP, one of the large index weights and an outperformer, has added 250 basis points to its position in the index.
- Gold stocks in aggregate have increased their weight more than 300-basis points after rising 120%.

- The banks number two to four (ANZ, Westpac, NAB) outperformed 17% and added 210 basis points to their weight.
- Our subset of AI high-impact stocks have fallen about 300 basis points from circa 7% of the index to circa 4% of the index.
- More recently, the Iran war has seen energy stocks rise 48% from their lows.

Each of these impacts in isolation is large and highlights the importance of risk management for both passive and active portfolios.

Exhibit 9: S&P/ASX 200 constituents (changes over last 12 months)



### Key themes from reporting season

#### Consumer and business demand, gross margins, productivity and AI impacts

After meeting with company management and looking deeply at their results, our team collate what the major themes were contributing to profit upgrades and downgrades (Exhibit 10).

The stark thing we see in the data is just how positive the themes were in terms of consumer demand, business demand, improved gross margins, and improved productivity outcomes.

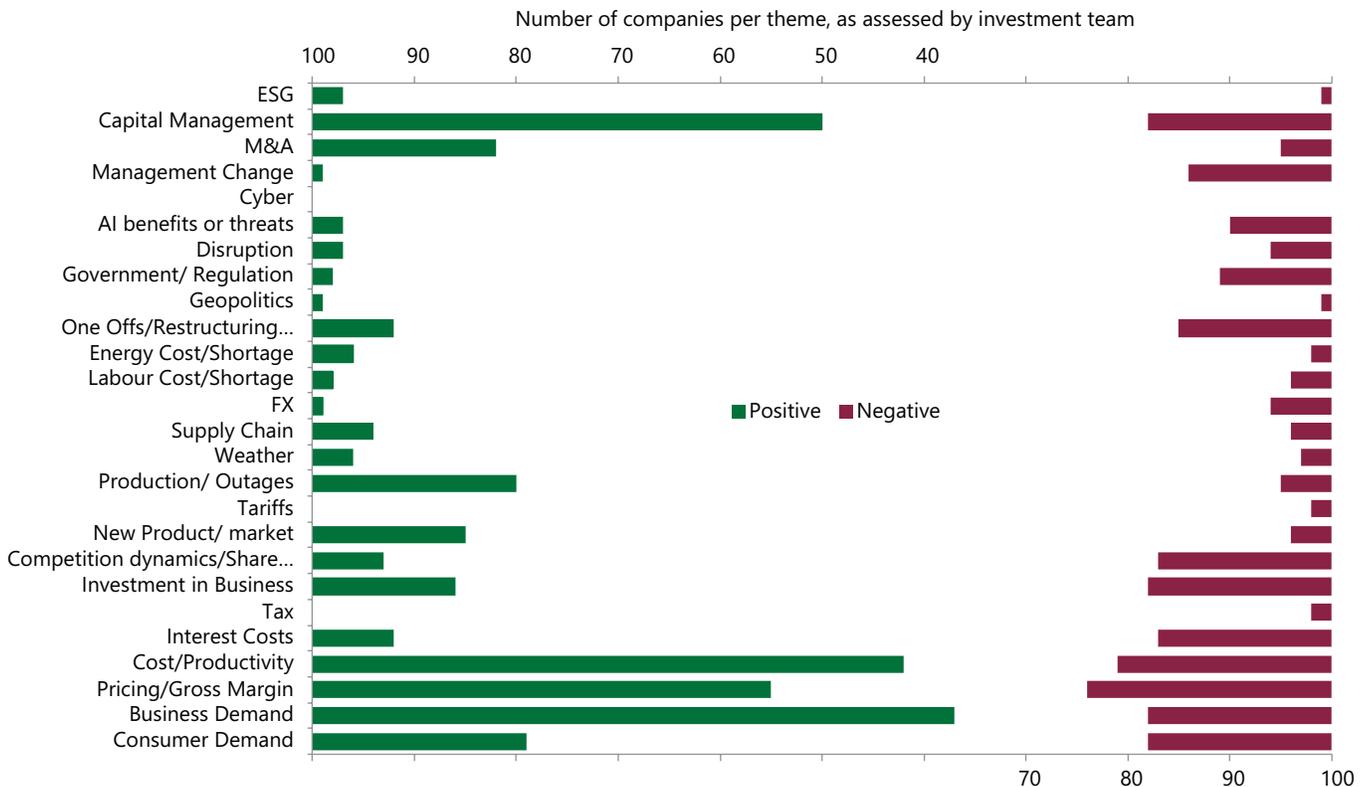
Miners' margins are growing on better commodity prices, as did those of peripheral mining services businesses and engineering names that rely on commodity prices. On the negative side, gross margins in segments like alcohol, and auto retail were under more pressure as changing consumer tastes see demand shift away from beer and wine and away from the products of Western automakers to their Chinese counterparts.

Capital management was also a feature for the period, with several buybacks announced – although we noted the rise of a new theme, the 'fake buyback', where buybacks were dependent on selling parts of the underlying business. There was an uptick in M&A activity, and several companies were under material pressure to cut dividends.

Executive Management turnover continued as a surprisingly significant theme, with 14 CEO/CFO changes announced during the reporting season.

Following on from the emergence of AI as a growing theme in the August 2025 reporting season, we saw companies describing in more detail their activities over the last five years, be it more simple machine learning or, in some cases, true artificial intelligence. Some of the fruits of their efforts are beginning to emerge in improvements in merchandising decisions, promotional decisions, workflow management and supply chains. Generally, however, there has been little evidence of positive reaction for the companies that are reporting success in using AI to improve their businesses.

Exhibit 10: Key themes impacting S&P/ASX 200 companies



## AI impact on the competitive moat and earnings risk of Australian companies

### Defining your moat

The most impactful new theme has been the threat of AI on software and content type companies.

When we're assessing the quality of a business, we do a fundamental assessment of their moat: the barriers to entry of the company, its cost position compared to peers, how much resilience the business has to withstand technology disruption, etc.

For incumbents, that moat is dependent on attributes such as scale, trust, cost position, capital investment in physical assets, regulatory barriers, and often, brand. Strong examples include companies like Telstra, the supermarkets, Wesfarmers, Brambles, Medibank Private, and shopping centre landlords like Scentre Group. These are large businesses, most with a significant physical presence, buttressed by regulatory capital, but whose growth is predominantly determined by the nominal growth in GDP of the Australian economy.

The "growth" companies of the last ten years have been the disruptive software or online e-commerce companies that tend to have very high return on equity because they are capital light. Those software and content type companies, such as Xero, Seek, CAR Group, REA Group, WiseTech Global, rely on unique software that solved problems for customers.

The focus has been far less about quality and durability of their moat, and more about how their total addressable market could grow from today.

### Exhibit 11: AI can be a risk or a tailwind



#### Xero

##### AI increases competitive dispersion

- **Low barriers to new entrants:** credible AI-native bookkeeping tools will evolve
- **Increased DIY threat:** LLM-enabled automation
- **Arms race risk:** Proliferation of AI features with unclear monetisation
- **Open borders:** Competitive environment is global
- **Larger global players:** Local only scale/data a disadvantage
- **Potential loss of mid-term pricing power**

Not necessarily impaired — but the range of outcomes has widened materially.

### AI impacts at the stock level are uneven

Consider a stock like Xero (Exhibit 11). Consensus valuations coming into reporting seasons required a 2-15% increase in US market share and pricing power of 5-10% p.a. to be justified. These valuations did not consider AI's impact on the changing competitive landscape on growth for the next marginal customer.

For Xero, AI has materially lowered the barriers to entry for an alternative AI-native bookkeeping software system. It doesn't mean that all existing customers change, as some will need more complex products, but the next small customer may be more likely to go for a lower cost alternative. This also impacts their pricing power, their ability to drive that 5-10% price increase because the new features and products are more likely to be developed with AI, lowering your ability to increase the price for that. At the same time, they're going to have to go through an arms race competing with incumbents that can invest more in AI to make products competitive.

Compare Xero to an incumbent physical business like Woolworths. For incumbent supermarkets, AI-enabled improvements to cost bases are not only readily apparent but, importantly, readily realisable in a significantly shorter time frame than a decade-long penetration of a potential addressable market.



#### Woolworths

##### AI enhances operating leverage

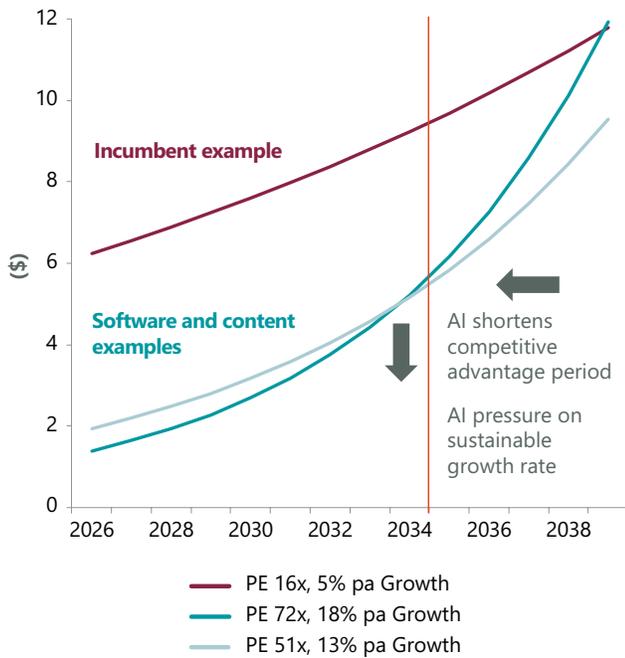
- **Efficiency:** Improved demand forecasting, inventory management and waste reduction
- **Optimisation:** pricing, promotions and supply chain logistics
- **Physical:** store network, supplier relationships and scale remain core advantages
- **Capital & regulatory barriers:** unchanged and significant
- **Border protection:** scale advantage in local Australian market is defensible and unaffected.

AI supports margin resilience and cash generation.

**“Who knows where AI is going to be in 10 years”**

We have illustrated this concept in Exhibit 12. Assume a A\$100 investment in an incumbent trading on a typical P/E of 16x. This stock is expected to generate earnings of \$6 p.a. today, growing at 5% p.a. on the back of long-run average nominal GDP growth.

**Exhibit 12: Illustrative example of the expected earnings stream generated from an A\$100 investment today\***



\*Data shown for illustrative purposes only.

Conversely, consider the case for investing in a software and content-type company prior to the February reporting season. They had been trading on an average P/E of around 72x. Put another way, for the share price to be justified, the software and content-type company’s annual earnings would breakeven with the incumbent in 2038.

The market was willing to trade on that multiple because these businesses have historically shown high ROE, high growth, and pricing power.

However, post reporting season, that average P/E has fallen to around 50x. Despite high growth expectations, annual earnings are around \$2.

AI is materially changing the expectations for earnings breakeven with established incumbents.

- It’s shortening competitive advantage periods and thus the level of earnings. A recurring line from CEOs we met with was, “Who knows what AI is going to do to our business in 10 years?”
- It’s lowering growth rates given lower pricing power and more competition going forward.

So, is your breakeven versus the boring incumbent still 2038, or is it now significantly further into the future like 2050 plus?

The de-rating has begun, but we would argue that as many of these stocks are so overvalued, especially since Covid, the fall isn’t finished yet, and you face a lot more work to identify the truly sustainable attributes to ensure their moat is strong enough to endure the new AI world.

### Growth vs. Value = Valuation

One of the problems a lot of fundamental managers have had in recent times is being ambivalent about Valuation, and/or being overweight a single factor like growth (i.e. the software and content stocks). Typical systematic funds tend to follow the momentum and recent behaviours of markets. As such, for an active fundamental approach to be successful, we think that risk management is critical.

This train of thought goes hand in hand with the 'growth versus value' style debate we have been talking about in our last few reporting season wraps and our recent Australian Equity outlook

We continue to see that the Australian market presents a historically significant Valuation opportunity. You can see this at the index level with the gap between the P/E ratios for each style (Exhibit 13), however, we prefer to look at this from a fundamental basis. We measure this using our proprietary valuation spread (Exhibit 14) which tracks the gap between the type of quality 'cheap' stocks (that we emphasise in our higher conviction portfolios) and the broader market. This spread is still at record levels, similar to what we saw in Covid, the GFC and the tech bubble.

Despite the pull back in growth stocks, and strong relative performance for Value-style portfolios over the last few months, the valuation spread remains is very large and a has a long way to go to return to more normal levels. This means it remains a great time to invest on a fundamental value basis.

Exhibit 13: Next twelve-month P/E ratios

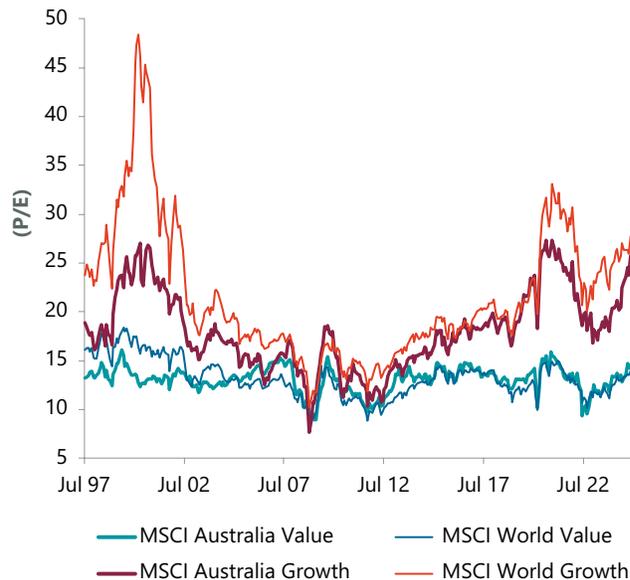
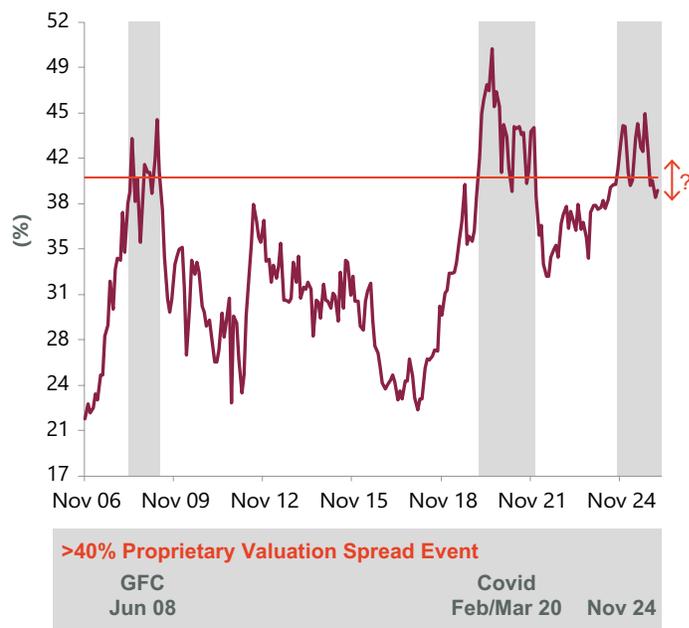


Exhibit 14: Proprietary Valuation Spread (relative)\*



\*Based on Proprietary Valuation of ClearBridge Australian Value Equity representative account vs. Proprietary Valuation of S&P/ASX 200 (log). Vertical grey bars based on period of >40% Proprietary Valuation Spread (relative) event

**Portfolio implications**

**'Mispricing' focus for active equity portfolios**

Alongside our Valuation approach, the focus of all our Active Australian Equity portfolios is to maximise "Mispricing", or the proprietary fundamental insight that remains after the systematic influence of style factors have been neutralised as we do in our Australian Active Insights portfolios, or tightly controlled in a way that is commensurate with the available risk-adjusted alpha, such as our Select Opportunities / Australian Value Equity portfolios.

There is, additionally a factor profile that comes "built-in" when you are targeting the most undervalued names. However, this "built-in" factor profile is not static. Today, the factor profile of our higher conviction Value-style portfolios is quite defensive (i.e. low beta) and it is the pro-cyclical type names of the market that are overvalued (Exhibit 15).

**Accelerating dividend and capital growth**

Australia's improving earnings and dividend environment offers a durable defensive solution for those who seek a reliable, growing income stream.

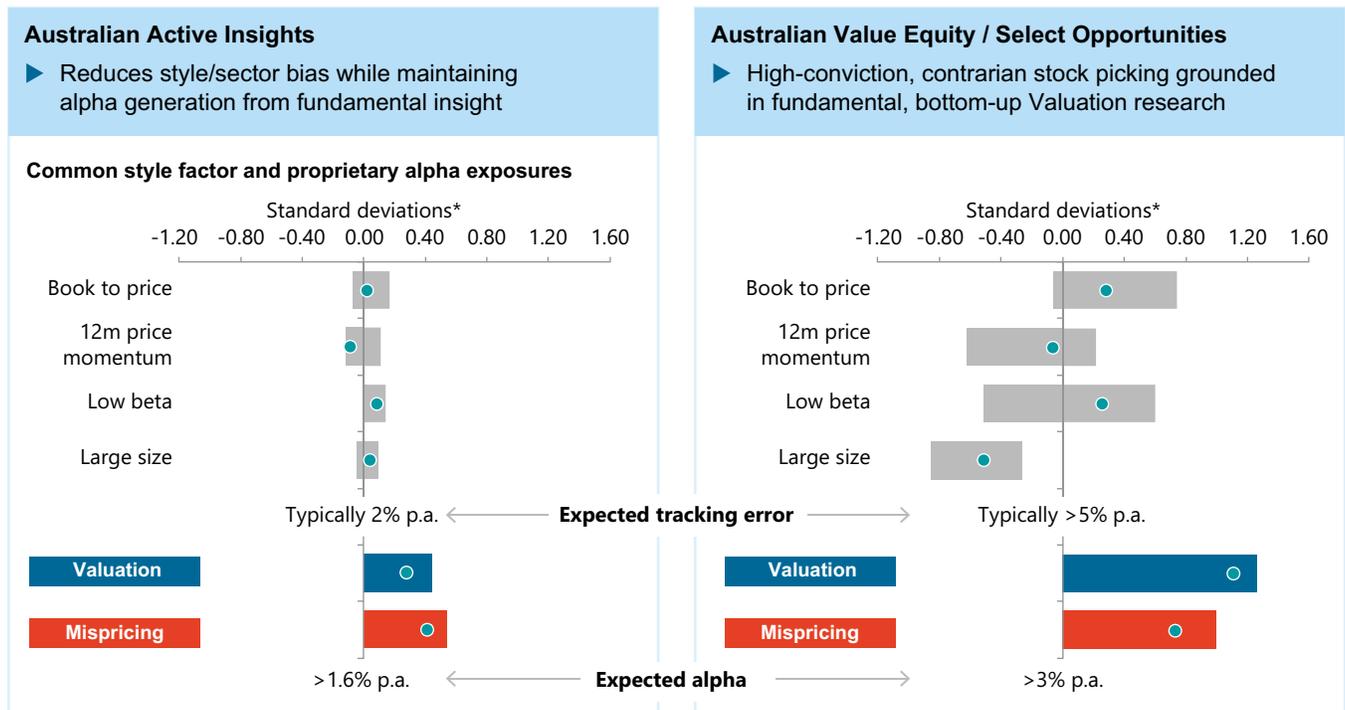
From the last peak in June 2022, the expected income yield for the S&P/ASX 200 Index had fallen to a record low. Improving expectations for EPS growth over the next twelve months, together with the retraction in the average P/E multiples, has seen this bounce back into the mid-3% range.

This remains, however, materially below the long-term bond rate. Income investors must be selective and diversified in their holdings to position their portfolio at a yield with at least a 50% premium to the 10-year bond rate.

Our Equity Income portfolios offer potential for low/zero tax paying portfolios to capitalise further on cash yield generation through franking credits and are positioned favourably through a relatively defensive factor profile.

For our listed Real Income portfolios, the total return expectation from its strong earnings stream growth, together with inflation-linked dividend growth, is an attractive equation.

**Exhibit 15: folio implementation reflects targeted client style, risk and return outcomes**



Source: ClearBridge; as of 28 February 2026. Data shown for ClearBridge Australian Value Equity (Select Opportunities) and Australian Active Insights representative accounts.

\*Relative to the S&P/ASX 200 Accumulation Index. Grey bars depict range since strategy inception. Blue diamonds depict current exposure.

### Performing during the fundamental 'winter'

Borrowing from the concept of "quant winters" — periods of prolonged underperformance for systematic strategies — the environment for fundamental, bottom-up investing has been out of favour relative to factor-driven approaches. However, our Australian Active Equity and income-focussed portfolios have performed strongly given the balance we have across factors and sectors.

### Conclusion

The February 2026 reporting season has reinforced the strength of the Australian economy, but more importantly, it provided a clearer lens into the durability of earnings in an increasingly uncertain and technologically disruptive environment. While aggregate results were positive, the lack of meaningful upgrades and heightened dispersion in share price reactions highlight a market still grappling with how to price forward-looking risks.

Central to this is the evolving role of AI in reshaping competitive moats. For asset-heavy and incumbent businesses, early evidence suggests AI is enhancing productivity, strengthening cost advantages and reinforcing existing market positions.

In contrast, for software and service-oriented companies, AI is lowering barriers to entry, compressing pricing power and challenging the sustainability of long-duration growth assumptions. As a result, the market has begun to re-evaluate the premium historically assigned to these businesses, though this adjustment may have further to run.

In this environment, understanding the true resilience of a company's moat is becoming increasingly critical. Earnings quality can no longer be assessed purely on historical growth or return metrics but must incorporate the potential for disruption and competitive intensity over time.

The persistence of the wide valuation dispersion continues to present a compelling opportunity for active management. By focusing on mispriced assets, investors can position portfolios to navigate both cyclical uncertainty and structural change.

Ultimately, protecting the 'castle' through identifying durable moats and avoiding those under threat will be key to generating sustainable long-term returns in the AI era.

Ultimately, just as our wrap began with the challenge of separating noise from substance, it closes with the same imperative: active, disciplined stock selection remains essential. By focusing on earnings power, capital discipline, and valuation discipline, investors can cut through volatility and position for stronger long-term capital and income outcomes, even as market dynamics continue to shift.

## About the Author



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- 33 years of investment industry experience
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- Graduate of Australian Institute of Company Directors

### Definitions

Key Definitions for analytical review and charts

**NTM:** next 12-month; **LTM:** last 12 months actual; **-12m:** one year earlier actual.

**Surprise:** companies where there is a difference between company reported results and broker consensus forecasts on a specific measure. Below: <-2%, Inline: between -2% and +2%, Above: >+2%.

**Revisions:** change in broker consensus NTM forecasts after companies have reported their results on a specific measure. Down: <-2%, Inline: between -2% and +2%, Up: >+2%.

**Revisions (composite):** average change in broker consensus NTM forecasts after companies have reported their results for Free Cashflow (FCF), Debt/Equity, EPS and DPS.

**Price reaction:** active return between company reporting and the S&P/ASX 200 Accumulation index for specified time period (alpha season: post result announcement through to 31 August 2025; 2-day:alpha for two working days post result announcement).

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**Source:** ClearBridge, FactSet. **Past performance is not a guide to future returns.** Unless otherwise noted, all data is through to 28 February 2026. Data is calculated using the weighted average of broker consensus forecasts of each portfolio holding – because of this, the returns quoted are estimated figures and are therefore not guaranteed and may differ materially from the figures mentioned. The figures may also be affected by inaccurate assumptions or by known or unknown risks and uncertainties.

**Broker consensus data:** The number of brokers included for each individual stock will depend on active coverage of that stock by a broker at any point in time. A median of brokers is typically utilised. All estimates avoid stale forecasts which are removed after a certain number of days.

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- Investing in foreign markets introduces a risk where adverse movements in currency exchange rates could result in a decrease in the value of your investment.
- This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the strategy's value than if it held a larger number of investments.
- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.
- The strategies mentioned may invest in derivatives (index futures) to obtain, increase or reduce exposure to underlying assets. The use of derivatives may restrict potential gains and may result in greater fluctuations of returns for the portfolio. Certain types of derivatives may become difficult to purchase or sell in such market conditions.
- Income strategy charges are deducted from capital. Because of this, the level of income may be higher but the growth potential of the capital value of the investment may be reduced.

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