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MIDF Strategy Team

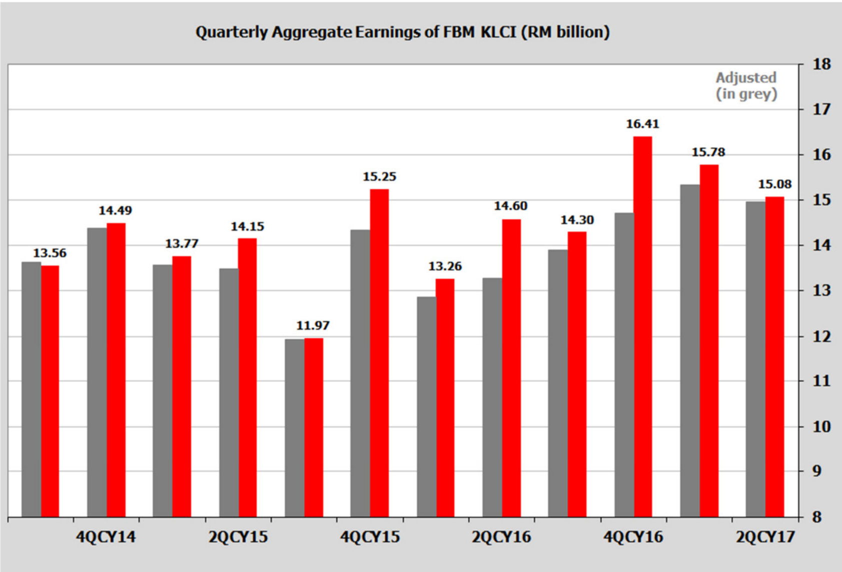
2QCY17: Earnings Preview

KLCI: 1,781.65 points

Expect further on-year earnings recovery

2017 Year-end Target: 1,830 points

FBM KLCI reported earnings may drop -4.4%qoq but increase +3.3%yoy. For the quarter ended June 2017, the aggregate reported earnings of FBM KLCI current constituents is estimated at RM15.08b. Against the combined RM15.78b earnings reported in preceding quarter, it is expected to record a negative sequential growth of -4.4%qoq in 2QCY17. On the other hand, the on-year reported growth figure is estimated to increase by +3.3%yoy.



Source: Bloomberg, MIDFR

2QCY17 aggregate adjusted earnings is estimated at RM14.96b

FBM KLCI adjusted earnings may decline by -2.4%qoq but surge +12.6%yoy. Nevertheless, adjusted for extraordinary and non-recurring items, the on-quarter growth may show a shallower decline of -2.4%qoq in 2QCY17. Moreover, the adjusted on-year growth number may surge +12.6%yoy in 2QCY17, i.e. two consecutive quarters of double-digit growth after the +19.2%yoy adjusted growth performance recorded in 1QCY17 quarter.

FBM KLCI: Quarterly adjusted earnings (RM million) and growth estimates

Sector (#)	2QCY17*	1QCY17	QoQ	2QCY16	YoY
Banking (7)	5,975.25	5,944.99	0.5%	4,920.51	21.4%
Utility (2)	2,056.80	1,754.79	17.2%	2,388.95	-13.9%
Telecommunication (4)	1,445.50	1,331.26	8.6%	1,184.16	22.1%
Plantation (4)	1,503.00	1,622.18	-7.3%	1,019.57	47.4%
Oil & Gas (3)	1,327.00	2,008.67	-33.9%	1,233.06	7.6%
Gaming (2)	976.44	879.27	11.1%	778.23	25.5%
Transportation (2)	675.34	798.17	-15.4%	863.42	-21.8%
Healthcare (1)	210.00	231.17	-9.2%	198.49	5.8%
Construction (1)	123.50	227.69	-45.8%	109.83	12.4%
Tobacco (1)	150.58	120.00	25.5%	113.06	33.2%
REIT (1)	180.90	176.73	2.4%	64.39	180.9%
Media (1)	187.90	145.10	29.5%	202.10	-7.0%
Diversified (1)	150.00	96.39	55.6%	210.11	-28.6%
Overall	**14,962.21**	**15,336.40**	**-2.4%**	**13,285.87**	**+12.6%**

Source: Bloomberg, MIDFR; E* – estimate, (#) – No. of constituent

Positive on-year growth performance for Banking, Telecommunication, Plantation and Oil & Gas. Among the FBM KLCI's high-weighted sectors, i.e. Banking, Telecommunication, Utility, Oil & Gas and Plantation, we are anticipating positive on-year adjusted earnings growth performance for Banking, Plantation, Telecommunication and Oil & Gas. On the other hand, the aggregate adjusted earnings of Utility constituents are expected to report a decline in its on-year growth. On a sequential basis, we are anticipating positive growth for Banking, Utility, and Telecommunication.

- **Banking.** The expectation of a +21.4%yoy jump for the banking sector earnings in 2QCY17 is likely contributed to the lower credit cost when compared to last year. In 2QCY16, majority of banks embarked on aggressive proactive provisioning especially for its exposure in the Oil and Gas industry. However, with oil prices stabilising, we expect lower provisions and possible writebacks on some of the loans. In addition, we expect loans growth to be better while NIM have either stabilised or improved slightly, contributing to better topline and earnings for the quarter.
- **Utility.** Tenaga's 3QFY17 earnings contracted against an exceptionally high base in 3QFY16 (which registered peak demand, driven by the heatwave); electricity demand registered a 2%yoy contraction in 3QFY17. Coupled with a spike in fuel cost (mainly due to the weak RM), 3Q17 core earnings were down 22%yoy. The earnings compression from higher effective fuel cost should be temporary given utilisation of RM1.3b PPA savings to compensate Tenaga from Jul17 onwards. To recap, ICPT should have effectively turned to a surcharge of 1.02sen/kwh instead of a rebate of 1.52sen/kwh given higher fuel cost. However, the Government is compensating Tenaga on behalf of consumers for the 2HCY17 period by utilising RM1.3b of the RM1.8b total PPA savings (estimated up till May17). Tenaga (BUY, TP: RM16.80/share) is still our top sector pick.
- **Telecommunication**. The expected year-over-year increase in telecommunication earnings will be driven by higher earnings from Telekom Malaysia Berhad (TM). We are expecting the broadband subscriber base to expand further, supported by the HSBB 2 and SUBB2 projects. We also view that ARPU growth to remain steady as the company upsell its products and services. In addition, we are also expecting better performance from some of Axiata's major operating companies.
- **Plantation.** We reiterate our NEUTRAL view on the sector with 2017 average CPO price of RM2,725 per MT unchanged. Having said that, we are watching the dry weather in United States closely as its could cause permanent damage to soybean crop in August and hence boost up CPO price to above RM3,000 per MT by end-2017. In the quarter of 2QCY17, planters' earnings are expected to improve year-on-year as the 6% rise in CPO price and 12% increase in production. However, we expect weaker quarter-on-quarter earnings due to 13% decline in CPO price. We have BUY calls on KLK (TP: RM29.25), TAANN (TP: RM4.30) and TSH (TP: RM2.15).
- **Oil & Gas.** Sector earnings will be supported by Petronas Dagangan mainly as the downstream retail sub-segment is still expected to be doing well. We are expecting earnings of Petronas Dagangan to be supported from sustained products volume sold. Petronas Chemicals, on the other hand, might face some headwinds as there could be additional supply flooding the market from Middle East. Meanwhile, for Petronas Gas, gas volume sold will be buoyed by strong local economic growth from industries.

Reiterate FBM KLCI year-end 2017 target at 1,830 points. We restate our assertion that empirical observations between earnings and price are conclusive with regard to the nature of their secular direct relationship. This is despite the ever present 'noises' from short-term price volatility which is influenced by market sentiment and other situational issues. Basing on the expectation of further earnings recovery this year, we reiterate our 2017 FBM KLCI target at 1,830 points. The baseline target equates to PER17 of 16.9x.

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BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.