

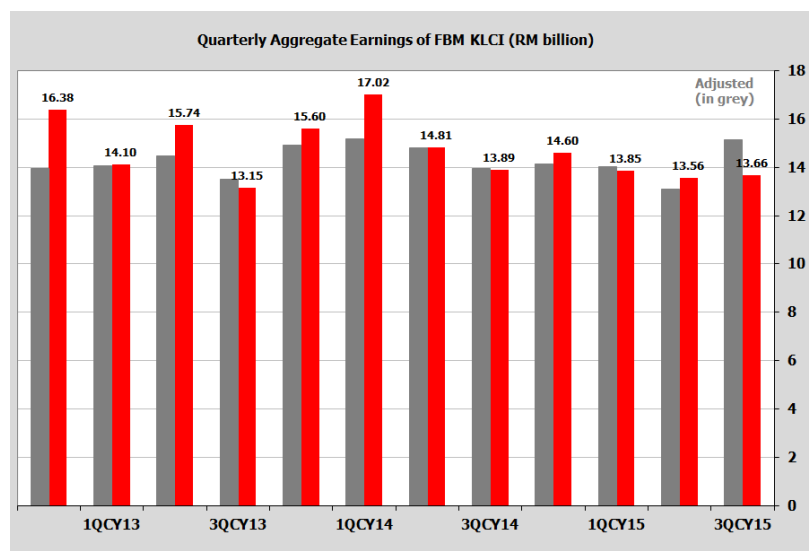
## 3QCY15: Earnings Preview

**KLCI: 1,685.70 points**

*Expect largely positive growth among major sectors*

**2015 Year-end Target: 1,650 points**

**Aggregate adjusted earnings of FBM KLCI stocks may increase +15.6%qoq and +8.5%yoy.** For the quarter ended September 2015, the aggregate reported earnings of FBM KLCI current constituents is estimated at RM13.66b. Against the combined RM13.56b earnings reported in preceding quarter, it is expected to record a rather minute sequential growth of +0.8%qoq in 3QCY15. Conversely, adjusted for extraordinary and non-recurring items, the on-quarter growth may be glaringly higher at +15.6%qoq. On the other hand, the on-year reported growth figure in 3QCY15 is estimated to fall by -1.7%yoy. However, the adjusted on-year growth number might be starkly better at +8.5%yoy, which is also a reversal to the -11.4%yoy adjusted growth performance of the prior quarter.



**3QCY15 aggregate reported earnings is estimated at RM13.66b (adjusted at RM15.15b)**

Source: Bloomberg, MIDFR

**Largely positive adjusted performance among major sectors.** We are expecting largely positive earnings performance among the FBM KLCI's Big 5 sectors, i.e. Banking, Oil & Gas, Utility, Telecommunication and Plantation. Of the Big 5 sectors, only Banking and Plantation are expected to report slight negative on-year earnings growth. On the other hand, we expect positive on-quarter growth for all Big 5 sectors excepting Plantation.


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

Sector (#)	3QCY15*	2QCY15	QoQ	3QCY14	YoY
Banking (7)	5,607.09	5,341.30	5.0%	5,620.05	-0.2%
Oil & Gas (4)	1,986.95	1,501.95	32.3%	1,685.83	17.9%
Utility (2)	1,879.30	1,088.33	72.7%	1,572.03	19.5%
Telecommunication (4)	1,790.62	1,684.22	6.3%	1,755.75	2.0%
Plantation (4)	1,235.90	1,579.92	-21.8%	1,243.84	-0.6%
Gaming (2)	892.09	298.83	198.5%	693.20	28.7%
Transport (2)	844.56	867.28	-2.6%	611.67	38.1%
Tobacco (1)	256.89	215.29	19.3%	241.10	6.5%
Healthcare (1)	255.80	228.11	12.1%	146.91	74.1%
Automotive (1)	144.15	68.44	110.6%	197.00	-26.8%
Media (1)	137.30	168.20	-18.4%	137.80	-0.4%
Property (1)	119.20	64.75	84.1%	57.92	105.8%
<b>Overall (30)</b>	<b>15,149.85</b>	<b>13,106.61</b>	<b>15.6%</b>	<b>13,963.09</b>	<b>8.5%</b>

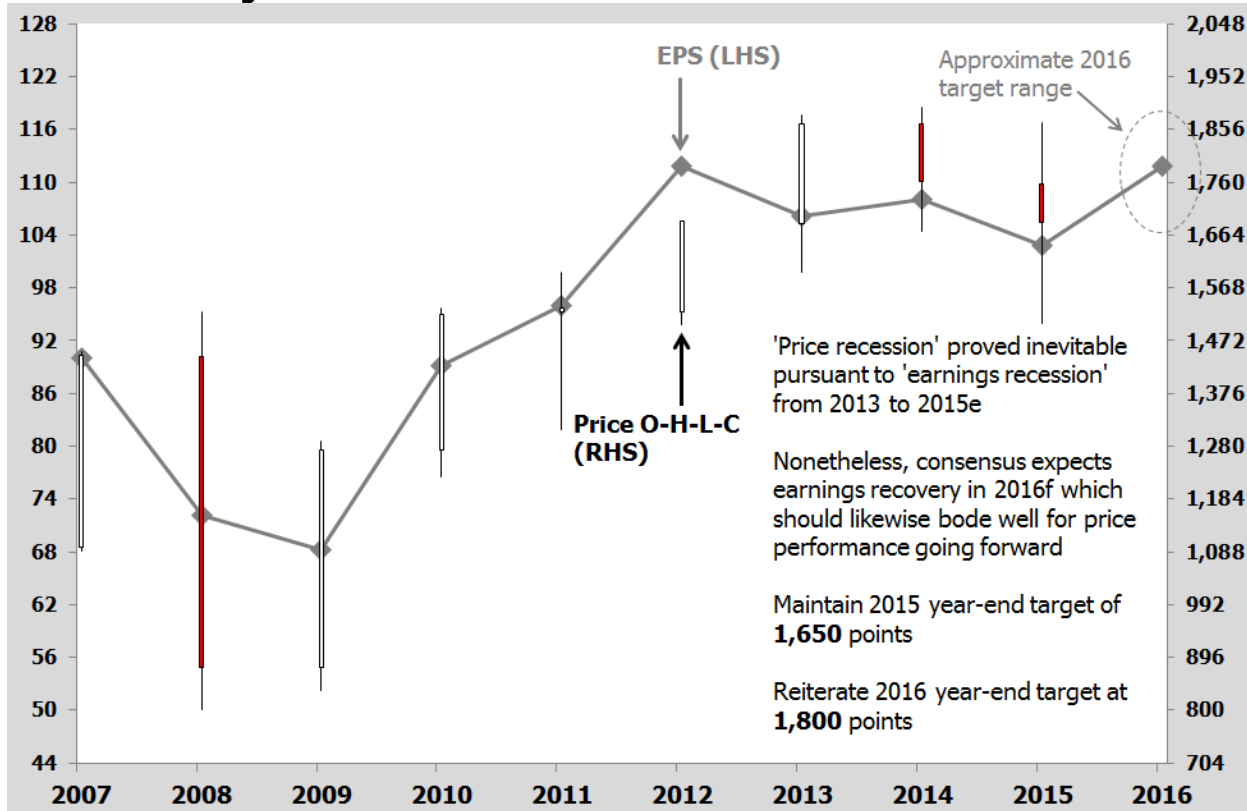
Source: Bloomberg, MIDFR; E\* - estimate, (#) - No. of constituent

- **Banking.** We continue to expect earnings growth of banks in 3QCY15 on year-on-year basis to remain unexciting. This is due to: i) persistent NIM pressure contributed by strong competition for deposits impacting banks' funding cost and lower asset yield, (ii) market volatility affecting treasury and IB income resulting in challenges to grow NOII and (iii) higher credit charge-off from lower recoveries as well as due to higher provisions due to asset quality weakness of international operations and upticks in impairment of domestic loans. Our top picks are Hong Leong Bank (BUY, TP: RM14.60) for its defensive qualities and Maybank (BUY, TP: RM9.80) for its diversified earnings and attractive dividend yield.
- **Oil & Gas.** On aggregate, the O&G constituent stocks registered mostly positive year-over-year earnings growth in 3QCY15. Petronas Chemicals' 3QCY15 earnings grew the most both year-on-year and quarter-on-quarter due to the exceptionally good plant utilisation rate of 88%. Petronas Dagangan also posted commendable year-on-year results as average selling prices were higher despite a decline in volume sold. However, Petronas Gas experienced a reversal in profit growth as its gas cost rose significantly subsequent to the government's decision of periodically removing subsidies on gas price. As for the only O&G service provider listed on Bursa, SapuraKencana staged a commendable growth (excluding the provisions done for its oilfields) as its drilling division experience a high vessel utilisation rate of 98.5%. Despite the challenging environment, we are still bullish on SapuraKencana (BUY, TP: RM2.89) due to its diversified business offerings and strong orderbook of RM23b.
- **Utility.** This sequential earnings growth of Utility sector was boosted by the recognition of the Imbalance Cost Pass Through (ICPT) for the 17-month period from January 2014 to May 2015 in the preceding quarter amounting to RM1.82b by Tenaga Nasional Berhad (TNB). Furthermore, its on-year earnings growth was contributed by the easing trend in fuel costs due to the decline in coal and gas prices, and couple with a more favourable generation mix. We maintain our BUY call on TNB with a TP of RM15.60.
- **Telecommunication.** The expected weak on-year growth performance among telecommunication players is reflective of the maturing and competitive industry landscape whereby ARPU is continually under pressure but expenditures, particularly for marketing and branding, remain high. This is further exacerbated by the introduction of goods and services tax in April 2015 which impacted the purchasing power of subscribers. We do not think the competitive and fast-evolving operating environment landscape will improve anytime soon. Widening the coverage area of 4G LTE as well as introducing more value added services would be some of the key determinant factors to remain competitive in the industry. Under the prevailing competitive landscape, we favour Digi (BUY, TP: RM7.04).
- **Plantation.** 3QCY15 average CPO price of RM2058/MT was lower by 7%yoy hence is likely to result in lower earnings for plantation companies. However, as for KLK, we are expecting earnings improvement on-year as its Manufacturing division is expected to recover from the losses in same quarter last year. Recall that in 3QCY14 (or 4QFY14 for KLK), the oleochemical sub-division in the Manufacturing division suffered a write down of RM13m due to a sharp drop in its selling products. Meanwhile, PPB may register modest earnings growth of 3%yoy as we expect its earnings recovery trend to continue. We also expect Wilmar's Oilseeds and Grains division margin to stay positive in 3QCY15 with higher volume processed. Quarter-on-quarter, 3QCY15 average CPO price of RM2058/MT was lower by 6%. Accordingly, we expect plantation companies to register lower sequential earnings. However, we expect PPB earnings to be much stronger on-quarter as Wilmar's Sugar Milling division usually turned into profit seasonally in 3Q due to the processing of harvested sugar cane in Australia.

**Beginning of the end to the earning drought?** Stabilization, or even more so improvement, in earnings sentiment could be an enduring catalyst for the equity market going forward. While corporate earnings had incessantly disappoint both ours and consensus expectations during the 6 previous result seasons, nevertheless, the ongoing reporting season has up until now seems pointing towards the beginning of the end to the prolonged drought in earnings growth. Recall that in 2QCY15 there were 9 underperformers against only 4 outperformers among FBM KLCI constituents (1QCY15: 10 underperformers, 0 outperformer). While it may be too early to tell, the ongoing 3QCY15 season might fare comparatively better as there is only 1 underperformer against 3 outperformers thus far out of 11 results released.

**Reiterate FBM KLCI year-end 2016 target at 1,800 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. Against the backdrop of recovering earnings growth next year, we reiterate our 2016 FBM KLCI target at 1,800 points. The baseline target equates to PER16 of 16.0x and +0.5SD. Also, we maintain our year-end 2015 FBM KLCI baseline target of 1,650 points (with upper and lower range of 1,700 and 1,600 points respectively) which equates to PER16 of 14.7x and -0.3SD. 

## FBM KLCI: Earnings versus Price



Source: Bloomberg, MIDFR

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#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> 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 <i>fall</i> 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.