

# Better corporate earnings seen in second quarter

But can the companies' 2Q profits keep pace with the stock market's rally?

BY BILLY TOH

KUALA LUMPUR: The road to recovery was the theme during the earnings reporting season for the first quarter of this year (1Q17). As the 2Q17 earnings season gets underway, investors are moving on to the next theme — that of sustainable revenue and earnings growth.

All eyes will be on whether the companies can repeat their performances seen in 1Q17.

Malaysia's stock market has regained some ground, with the FBM KLCI and FBM Small Cap Index earning a total return of 9.9% and 18.3% respectively so far this year. But will the companies' 2Q17 earnings keep pace with the rally in the local equity market?

According to JF Apex Securities Bhd head of research Lee Chung Cheng, companies are likely to report better earnings in 2Q17 compared with the year-ago period in line with the better outlook for the year on the back of improved economic activity.

"However, we'll have to wait for [Malaysian company] earnings to catch up with the stock market valuation. The market won't be cheap," Lee told *The Edge Financial Daily* over the telephone.

In a report dated Aug 2, Maybank Investment Bank Research (Maybank IB Research) said data points to the country sustaining its growth momentum of 1Q17, where gross domestic product (GDP) growth was 5.6%.

"Our economics team forecasts 5.1% real GDP growth in 2017, while the official 2017 real GDP growth forecast of 4.3% to 4.8% could be raised soon, potentially together with the release of 2Q17 GDP on Aug 18," it added.

Still, going into 2H17, Maybank IB Research remains "cautiously constructive" on Malaysian equities, with a slightly neutral bias after 1H17's gains.

"For Malaysian equities, the key positives are the domestic macros which should remain positive throughout 2017 while market/corporate earnings growth looks set to resume. That said, we stay mindful of the prevailing external policy and geopolitical headwinds, amid an extended period of market calm and low volatility for most of 2017 year to date (YTD).

"Volatility, as measured by the Chicago Board Options Exchange Volatility Index, has continued to stay at low levels. Volatility has also retreated in the other asset classes with the exception of crude oil," it said.

While optimism abounds,

Can 2Q earnings catch up with share price rally?



Mercury Securities Sdn Bhd head of research Edmund Tham said the market has become more cautious as reflected in its trading volume. "If you look at the trading volume, it has gone down quite significantly. At one time, the average daily trading volume was consistently above three billion shares. Right now, it's only about one billion shares," Tham told *The Edge Financial Daily*.

The average daily trading volume on Bursa Malaysia stood at 2.8 billion shares in 1H17 but it has since tapered off. Last Friday, trading volume totalled 1.42 billion shares worth RM1.47 billion.

Meanwhile, Tham expects both upside and downside earnings surprises in this reporting season rather than things being good or bad for a specific industry.

Below are the expectations and views of analysts for the 2Q17 earnings season in some of the sectors:

## Construction

According to Public Investment Bank Bhd research analyst Tan Siang Hing, most of the construction companies under its coverage will continue to see good earnings.

"They (earnings) will still be good. The earnings visibility of most of them is still good. Given the higher order book seen, technically, the earnings will also be higher," he said.

While Tan conceded that the valuations of construction stocks are not cheap, he said their share prices tend to move in tandem with news flow.

"If there is news flow to support, the share prices will be able to sustain," he said, pointing to the light rail vehicle work package valued at RM1.56 billion that was awarded to the consortium of CRRC Zhuzhou Locomotive Co Ltd, Siemens Ltd China and Tegal Dinamik Sdn Bhd recently.

In a report dated Aug 3, Maybank IB Research construction analyst Adrian Wong said there are expectations of major civil packages (via-ducts and guideways) to be awarded

next, with potential beneficiaries including Gamuda Bhd, JIM Corp Bhd, Sunway Construction Group Bhd and Kimlun Corp Bhd.

YTD, the Kuala Lumpur Construction Index has outperformed the benchmark FBM KLCI Index with a total return of 19.8%.

## Semiconductor

MIDF Research analyst Martin Foo Chuan Loong is optimistic about semiconductor companies' financial performance for 2Q17.

This is supported by the latest export data which showed Malaysia's exports rising 10% year-on-year to RM73.1 billion in June, as the country sold more electrical and electronics besides palm oil products.

"Take a look at the events that will unfold in this quarter, with Apple expected to launch the latest iPhone and Samsung a new Note, and this is just the big players we are talking about. In order for these stocks to be ready, production is required in 2Q17.

"Thus, production volume would be ramped up [which should lead to better earnings [for semiconductor companies]]," said Foo.

He also pointed to the improved global sales data, which should bode well for 2Q17.

On how a stronger ringgit would affect exporters such as the semiconductor players, Foo said most of the players in this space have a natural hedge to the currency.

"Usually, only about 50% of the cost is in US dollars. I don't think the impact from foreign exchange fluctuations will be significant," he added.

Nevertheless, Foo agrees that the valuations of semiconductor stocks are currently on the high side, noting that the share prices have run ahead of earnings season.

## Banking/Finance

The banking sector is expected to post muted earnings, with 2Q17 results expected to be marginally higher from a year ago but would not reflect the strong earnings

seen in 1Q17, said Hong Leong Investment Bank Research analyst Khairul Azizi Kairudin.

He pointed out that due to the Hari Raya festive holidays, which resulted in June being a shorter month, leading to lower loan applications, there could be a moderation in bank earnings growth in 2Q17 compared with 1Q17.

"On the outlook for the banking sector, we maintain our 'neutral' stance due to modest growth outlook for earnings, loan and deposit growth. The modest earnings growth will result in lower ROE (return on equity) and the lower expected return," he said.

Maybank IB Research also has a "neutral" call on the sector but expects loan growth to pick up pace in 2H17.

"The pickup in non-household loan growth is encouraging, and we look forward to ongoing expansion in this segment if our industry loan growth estimate of 5.4% for 2017 is to be achieved, against annualised loan growth of 3.5% to date," said Maybank IB Research banking analyst Desmond Ch'ng in his report dated Aug 2.

## Aviation

CIMB Equities Research regional transport analyst Raymond Yap is confident that AirAsia Bhd's 2Q17 results will outperform that of 1Q17.

"We believe the higher domestic market share will help improve 2Q17 and 2H17 (second half of 2017) yields, helping reverse the yield pressures in Malaysia felt during 1Q17," he said.

"We believe load factors rose from 88% in 1Q17 to an all-time high of 90% in 2Q17. AirAsia's 1Q17 results disappointed the market due to the RM140 million to RM150 million one-off moving cost but we think this is unlikely to recur in 2Q17.

"Macro factors are also supportive of stronger earnings as the US dollar weakened 2.6% quarter-on-quarter (q-o-q) to an average of RM4.33 while jet fuel prices fell

4.3% q-o-q," Yap said in a report dated July 17.

MIDF Research analyst Tay Yow Ken also expects AirAsia to post better results in 2Q17 based on its preliminary operating statistics.

"The operating statistics showed demand was slightly higher than expected, even though second quarter is traditionally a weak quarter," he said.

On the industry outlook, Tay is positive about both AirAsia and Malaysia Airports Holdings Bhd in 2H17, pointing to more sporting events as well as the easing of visa applications, which would lead to higher tourist arrival in the country.

## Media

The outlook for the media industry, meanwhile, remains challenging.

"Although we see improvements in the macro environment, we have yet to see a substantial recovery in the media sector, largely because companies still remain cautious and adopt a wait-and-see approach to adex (advertising expenditure) spending," a media analyst who declined to be named said.

"In addition, media companies also face the gradual but long-term structural shift in consumer preference towards mostly free online content. Although media and telecommunications players are trying to adapt and change by digitalising their business models, it's not easy to monetise digital content in this information-exploding era.

"In Malaysian Newsprint Industries Sdn Bhd's (MNI) case, its [liquidation] was mainly because of the cheap imports that rendered the local manufacturing firm with higher production costs uncompetitive," he said.

Last week, Hong Leong Industries Bhd and Media Prima Bhd announced that MNI had initiated creditors' voluntary winding up proceedings amid declining newsprint demand and three straight years of losses.

Kenanga Research analyst Cheow Ming Liang also shared the same sentiment in his report dated July 20.

He said while the country's 2017 adex sentiment is set to be supported by several major events such as the Asean@50: Golden Celebration Campaign, 29th Southeast Asian Games, ninth Asean Para Games, and a potential 14th General Election, these feel-good factors are likely to be offset by a weak ringgit against the US dollar and the rising cost of doing business.