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# Bleak corporate earnings ahead

Sluggish global economic outlook and weak domestic consumption among contributing factors

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**PETALING JAYA:** There are signs emerging that overall corporate earnings during the current results season will be weaker than last year.

Despite a recent rally in shares, which was partly attributed to foreign capital inflows, analysts have said that prospects of a sustained earnings recovery remain weak due to a multitude of factors.

The steep 3% decline in the FTSE Bursa Malaysia KL Composite Index (FBM KLCI) during the final week of April underscored the concerns by investors that share prices may have exceeded fundamental justifications yet again.

In an April 27 note, UOBKayHian Research said external and domestic socio-economic structural challenges would persist this year.

“Key challenges ahead include slowing

domestic consumption growth and a steadily rising unemployment rate, which had crept up to 3.4% in February. Corporate earnings growth, which has derailed from gross domestic product (GDP) growth over the past three years, is just making a meek mid-single-digit growth recovery in 2016,” it cautioned.

According to UOBKayHian, a more recent phenomenon is the large sell-down of high-flying stocks such as Globetronics Technology Bhd and Cahya Mata Sarawak Bhd, which it said was indicative of a market-wide profit-taking activity among investors. Between April 25 and April 29, the FBM KLCI dropped from 1,713 points to as low as 1,660 points.

Banks and telcos, which take up a large proportion of the FBM KLCI's component stocks and are particularly vulnerable to domestic headwinds, led the decliners. The benchmark index closed at 1,672.20 points on April 29, its lowest in two months.

It is no surprise that the FBM KLCI companies are viewed as the bellwether of economic growth.

According to official estimates by Bank Negara, Malaysia is projected to achieve a GDP of between 4% and 4.5% this year. The country's GDP grew at 5% last year, thanks to greater contribution from manufacturing exports due to the weaker ringgit, which offset the downturn in commodity prices.

With the economy expected to grow at a slower pace, it begs the question as to how companies intend to grow their earnings base in the coming year.

Tenaga Nasional Bhd's (TNB) sales figures from its recent results can be used as an indicator of electricity demand in the manufacturing sector, a key backbone to the nation's economic and trade growth.

Electricity usage tends to be correlated

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## Heat wave pushes electricity demand to all-time high

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with economic growth, as about three quarters of TNB's electricity sales come from industrial and commercial users.

While analysts had initially projected slower sales due to the lower GDP forecast this year, the recent heat wave had the effect of boosting electricity demand to an all-time high of 17,788MW on April 20. TNB reported a 4% increase in electricity demand during its second quarter ended Feb 29, 2016.

However, according to AllianceDBS in a recent note, over the same period, growth from domestic users increased by 12%, outpacing the 6% growth recorded by commercial users. This could mean that the bulk of added electricity demand since then mostly arose from domestic users as opposed to commercial ones.

Not only are companies cutting cost to cope with higher electricity charges, the slowing demand for products has also caused their utilisation rates to go down. This means that the earnings prospects for these manufacturers would be flat at best, analysts said.

Elsewhere, the consequence of lower domestic consumption even had an impact on so-called defensive companies which are supposed to weather the effects of an economic downturn better than most.

For example, shares of British American Tobacco (M) Bhd fell to a four-year low recently after reporting a 28% plunge in year-on-year (y-o-y) profits to RM172.61mil for the first quarter of financial year 2016. The company's monthly average sales volume has also declined by 34% y-o-y as consumption continued to decline.

Going forward, the current weakness seen in the stock market may start to be reflected in corporate earnings as more companies disclose their results in the coming months.

"The sluggish global economic outlook and weak domestic consumption will likely lead to lacklustre first-quarter earnings. Aside from aviation and construction, there are few other sectors to get excited about this year in terms of significant earnings growth," said a bank-based research house analyst.