Corporate earnings seen to drop q-o-q, dragged down by ongoing lockdown

BY **LEE WENG KHUEN**

The prolonged lockdown has put a huge dent in the operations of businesses, affecting their financial performance.

Tighter lockdown measures have also led to changes in business cycles and consumption patterns.

Given the adverse impact of the pandemic, MIDF Amanah Investment Bank Bhd research head Imran Yassin Yusof foresees a quarter-on-quarter (q-o-q) decline of 16.4% for the FBM KLCI's 30 component stocks in the upcoming corporate earnings season for the quarter ended June (2Q).

"This is partly due to Phase 1 of the National Recovery Plan (NRP) that was announced towards the end of 2Q, which may have an impact on earnings," he tells *The Edge*.

However, on a year-on-year basis, corporates are likely to see a strong improvement in earnings.

"We are expecting earnings to more than double when compared against 2Q2020 earnings given that we were in the first Movement Control Order (MCO 1.0) period last year. For additional context, we believe that Phase 1 of the NRP will have a lesser impact when compared against MCO 1.0, given that more economic sectors are allowed to operate," he explains.

In June, Bursa Malaysia granted an automatic one-month extension for the issuance of quarterly and annual reports due on July 31, for companies listed on the Main and ACE Markets.

The aggregate reported earnings of the FBM KLCI's 30 constituents expanded to RM20.3 billion in 1Q, representing q-o-q growth of 32.9% and y-o-y growth of 167.4%.

The construction, healthcare, industrial, plantation, property, telco and media, and transport and logistics sectors recorded improved total earnings in 1Q compared to both the preceding quarter and corresponding period last year.

Financial services was the only sector that registered both negative sequential and y-o-y earnings growth in 1Q, principally due to the more than RM4.7 billion one-off settlement and impairments incurred by AMMB Holdings Bhd, according to MIDF.

For 2Q, earnings of the index-heavy banking sector are expected to come in lower compared with 1Q owing to the stricter lockdown.

"There was slightly more activity in 1Q. People are not coming in to apply for loans because of the ongoing lockdown," says Kenanga Research banking analyst Clement Chua.

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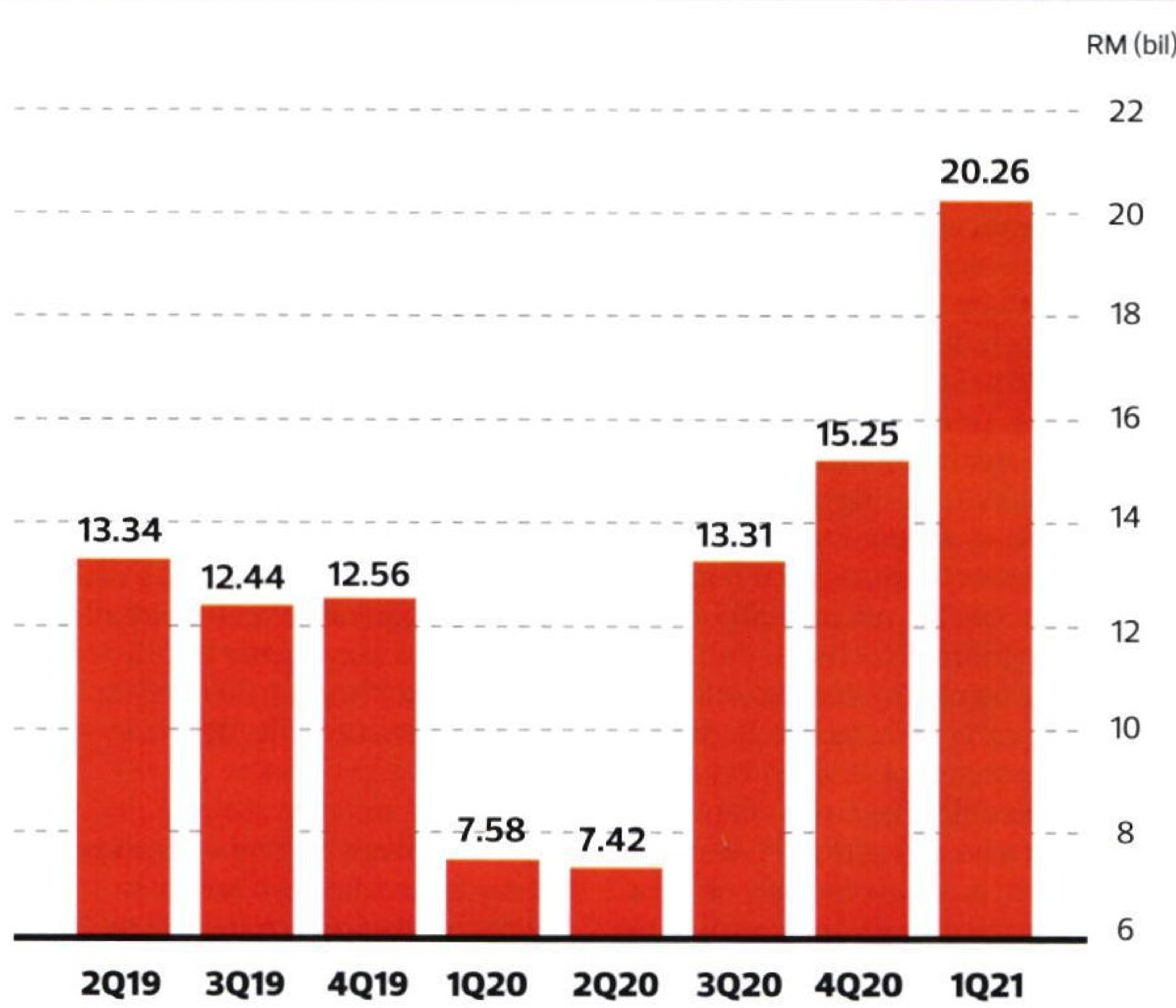
Quarterly aggregate earnings of FBM KLCI component stocks



"Based on Bank Negara Malaysia's statistics, the housing loan segment has been driving loan growth, thanks to the subsale transactions and not so much the new properties. Banks were also hoping for auto loans to be one of the drivers," he adds.

Imran says the lockdown impact hinges on the restrictions placed under Phase 1 of the NRP. "Sectors that have earnings tied to movement such as consumer and hospitality will see a bigger impact than export-oriented sectors."

He expects glove players to continue to register strong earnings because of the ongoing pandemic. Kossan Rubber Industries Bhd, for example, has reported a new record quarterly net profit of RM1.06 billion for 2Q, more than eight times the RM131.06 million it registered a year earlier and slightly higher than the RM1.04 billion in 1Q.

This was attributable to higher average selling prices (ASPs) and glove demand, but Kossan warned that ASPs are set to fall as vaccinations are being ramped up globally.

Although the glove players have posted high earnings, Imran notes that some of the earnings could have been mitigated by the lockdown, which was implemented in June.

Besides the glove sector, he highlights that the energy and plantation sectors could see better results given the high prices of commodities.

The consumer sector, on the other hand, is likely to record a worse performance on a quarterly basis, as the challenging economic environment weighed on consumption spending.

Rakuten Trade head of research Kenny Yee says the manufacturing-related sector will also feel the heat due to plant closures. As only part of the lockdown impact was felt in 2Q, he observes that the market has not experienced a significant downgrade in earnings.

"The bulk of the FBM KLCI earnings are from the banking sector, so the overall impact may not be that drastic," Yee says.

He also sees high crude oil prices having a positive impact on contract flows in the oil and gas sector.

Recently, Sapura Energy Bhd secured seven contract wins and extensions in Malaysia and Thailand with a combined value of RM1.2 billion.

Yee notes that property developers remain under pressure, although some companies managed to achieve their sales targets. Similarly, construction firms are forecast to register lower earnings as contract flow was not active, coupled with higher raw material prices.

But he sees "reasonable earnings" by real estate investment trusts (REITs). On a q-o-q basis, IGB REIT's net property income (NPI) increased 1.2% to RM63.14 million for 2Q. Axis REIT also saw its NPI grow 6.2% q-o-q to RM53.44 million.

While the technology sector has been the key performer on the local bourse, Kenanga Research head Koh Huat Soon cautions that there could be a risk for tech players as a result of the global chip shortage. Moreover, they were also affected by the Enhanced MCO, which put a limit on the number of workers allowed at the plants.

Nonetheless, automated test equipment maker ViTrox Corp Bhd's 2Q net profit more than doubled to a record RM50.64 million from a year ago. It was also much higher than the RM30.7 million in 1Q.

Muted sentiment

Yee says investor sentiment on the stock market is mostly muted as the local bourse has been consolidating for some time.

"Unless there is a clearer picture, we will see some funds flowing back to the stock market. Nobody knows when the lockdown will end. The longer the lockdown, the greater the impact on corporate earnings."

Despite China's recent crackdown on the technology sector, he is of the view that it will not fuel a massive selloff in the regional markets.

"Of course, we will see a knee-jerk reaction. But I'm sure there will be bargain hunting."

Yee says because the foreign shareholding in the local market is low, the crackdown will not result in huge selling pressure. Furthermore, he believes the market will continue to be supported by earnings growth in the index-linked counters.

Imran says corporate earnings may provide a reassessment of future earnings and some guidance on future performance. "This, in turn, should allow investors to reassess the fair value of the companies and their relation to the current share price."

Year to date, the benchmark FBM KLCI has declined 7% to close at 1,512.93 points last Thursday. ■