Balance sheet, cashflow matter

MARKETS

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Rakuten Trade research head Kenny Yee said with all the uncertainties surrounding corporate earnings, it is essential to re-look at valuation methodologies as the traditional PER and earnings per share (EPS) may no longer be valid during the pandemic.

beneficiaries of the coronavirus (Covid-19) pandemic and the plantation sector.

Yet corporate earnings are still marred with uncertainties as analysts are unable to gauge the eventual impact of the pandemic, mainly due to the 45 days of non-operation for most businesses due to the movement control order (MCO) since March 18 before it was converted into a conditional MCO on May 4.

Rakuten Trade Sdn Bhd is projecting that the FBM KLCI would close at around 1,400 points at the end of this year, based on 15 times its market price-to-earnings ratio (PER), barring any drastic revision of corporate earnings.

It is expecting earnings growth to contract by 3.9% this year, with the gaming sector taking the heaviest beating at 42.2%.

Rakuten Trade research head Kenny Yee said there could be a risk of the plantation sector pulling down the earnings growth with a further slash in earnings for the sector, which would derail the FBM KLCI target.

Based on current consensus, analysts are expecting a 40% growth in the plantation sector on the back of projections of better crude palm oil (CPO) prices this year.

“As we move down this year, I think expectations (for the plantation) sector could be lower and lower. So that could be the main road bumps for corporate earnings growth moving forward.

“As for banks, there has been an overall downgrade hence, we’re seeing corporate earnings to be in the negative phase again this year. I think there will be more downgrades, ” he told a virtual media briefing on the market outlook yesterday.

Yee said banks would still be an enigma as the actual impact from the lower interest rates and the six-month moratorium could only be seen over the next two quarters.

CGS-CIMB Equities Research head Ivy Ng (pic below), when contacted, said corporate earnings in the second quarter were likely to be weaker than the first quarter due to the longer MCO impact.

The research house had earlier downgraded its year-end FBM KLCI target to 1,348 points and an earnings forecast of -9.1%.

With all the uncertainties surrounding corporate earnings, Yee pointed out that it is essential to re-look valuation methodologies as the traditional PER and earnings per share (EPS) may no longer be valid during the pandemic.

“We may pay more attention to a company’s balance sheet as well as the free cashflow of the company to ascertain its sustainability over the longer period than just a simple EPS or PER.

“We would prefer to take note of companies’ cashflows and business models, going forward. What we think is cheap now may not be so if earnings are to decline further, ” he said.

The FBM KLCI is currently trading at 16.4 times the estimated PER, which Yee said was higher compared to regional peers.

This may spike up to a level of 20 times if earnings were worse than expected.

Yee expected another dip in the markets but rather than it being due to poor earnings results, it would be due to the performance of Wall Street, which he said was solely based on expectations.

"This thing cascaded down to the regional markets as well hence, we continue to advise investors to exercise caution, not to be too overzealous and not to be too greedy, " he said.

Yee also commented that the recent uptrend in stock prices has outpaced that of their actual fundamentals and cautioned that the higher the market has strengthened, the more dangerous it is for it to decline further.

This, he said, was due to liquidity which has led to high participation from retail investors.

Asked if the market has passed its panic-selling phase, Yee said the local market has entered into a phase of more negatives than positives and it would not be difficult to ignite another round of panic selling.

On the average, the volatility of the Asean markets has surged between 60% and 100%, with most markets being sustained by high liquidity.

"I'm not saying there will be another panic selling but to ignite one is not difficult at all.

"That's why we have to be very cautious of the reason why the market has moved up steadily over the past few weeks. It's all liquidity-driven without any fundamentals, " he said, adding that the only way the market could have a more solid footing is with the emergence of a vaccine and with the pandemic cleared.

Yee expected active retail participation to continue, saying that the bull run in the mid-1990s saw retail participation surpassing institutional participation at one point.

Currently, it is around 65% institutional and 35% retail.

Amidst all uncertainties, Rakuten's top picks are Ancom Bhd (target price 90 sen), Supercomnet Technologies Bhd (98 sen), LYC Healthcare Bhd (68 sen), Bahvest Resources Bhd (68 sen) and RCE Capital Bhd (RM1.95).

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