Strategy Report

HK market earnings season review

FY21 earnings season is now over in HK market. Results have been disappointing, with more misses than beats, and FY22E earnings slightly revised downwards. We examined results, revisions and growth outlook of each industry, and picked sectors which may have better earnings growth in Q2 or have over-reacted to recent risks.

- **Half of HSCI constituents reported earnings miss in FY21**. Aggregate earnings were 5.2% lowered than consensus. Financials and Energy reported in-line aggregate earnings, while all the other sectors missed. Utilities and Consumer Staples were the most disappointing sectors with the least beats, possibly due to higher cost pressures.
- **HSI / HSTECH FY22E earnings cut by 0.9% / 4.1%**. From 21 Feb to 6 Apr 2022, the FY22E EPS of the HSI and HSTECH dropped by 1.9% and 5.1% respectively. We estimate that around 1.0% and 1.1% of those revisions were due to changes in constituent stocks.
- **Earnings revisions by sector – Commodities up, Consumer down**. This result season largely overlapped the outbreak of Russia-Ukraine military conflicts, resurgences in COVID-19 in China, and the US Fed's turning more hawkish. As such, FY22E earnings revisions were affected not only by the FY21 results but also these major risks. Energy, Materials and Banks were the only sectors which enjoyed upward revisions in FY22E earnings.
- **FY22E earnings growth – strongest in Consumer Discretionary thanks to low base**. The industries which are expected to post the biggest earnings growth are, perhaps unsurprisingly, those which have been hardest hit by COVID-19 over the past two years, and thus had low earnings bases or even losses (Hotels & Travel, Casinos) in FY21.
- **Sectors views:** 1) Internet's earnings growth is bottoming out, and sentiment may improve; 2) Infrastructure would benefit from more pro-growth policies, backed by accelerating issuance of special bonds; 3) Consumer Staples leaders with strong pricing power may have over-reacted to cost concerns; 4) Energy / Metals might underperform with risks of profit-taking, as optimism of Russia-Ukraine ceasefire is building up and the US Fed's policy tightening may bring downward pressure on commodity prices.

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Market Data

Hang Seng Index	22,081
52-week High / Low	29,491/18,235
3-month avg. daily t/o	HK$146.4bn

Source: Bloomberg

Indices Performance

	HSI	HSCEI	HSTECH
1-month	4.91%	2.6%	1.3%
3-month	-6.0%	-7.6%	-16.6%
6-month	-10.6%	-12.7%	-25.7%

Source: Bloomberg

12-month HSI Performance

Source: Bloomberg

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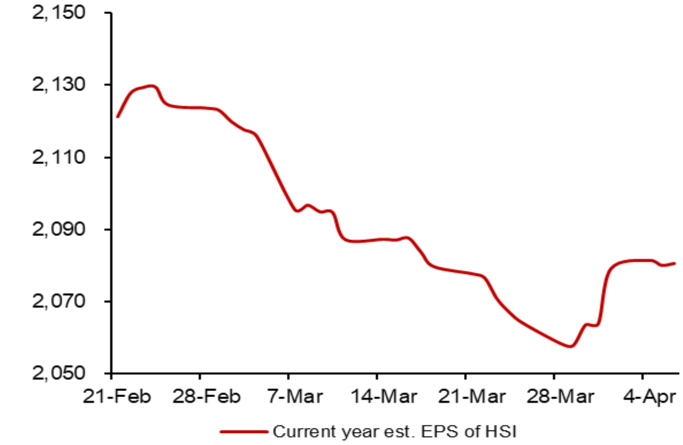
HSI / HSTECH FY22E earnings cut by 0.9% / 4.1%

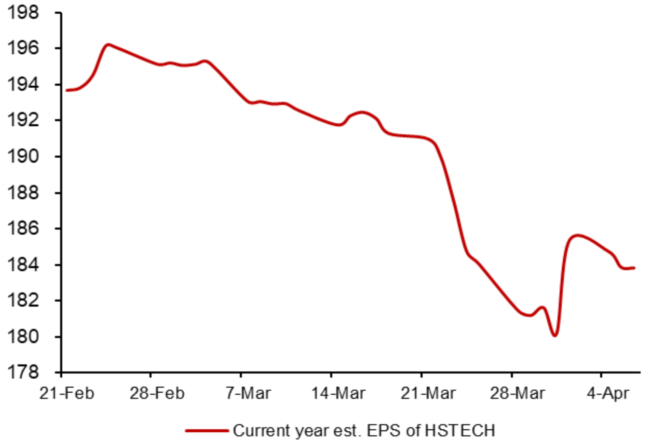
Firstly, let's have an overview of earnings estimates of major indexes in Hong Kong market after this result season. From 21 Feb to 6 Apr 2022, the FY22E EPS of the Hang Seng Index and the Hang Seng TECH Index decreased by 1.9% and 5.1% respectively. We estimate that around 1.0% and 1.1% of those revisions were due to changes in constituent stocks on 7 Mar. Adjusting for such changes, FY22E EPS of the HSI and HSTECH were revised down by 0.9% and 4.0% respectively in this result season.

Figure 1: HSI's FY22E EPS cut by 0.9% (adjusted for changes in constituent stocks)



Source: Bloomberg, CMBIGM

Figure 2: HSTECH's FY22E EPS by 4.0% (adjusted for changes in constituent stocks)

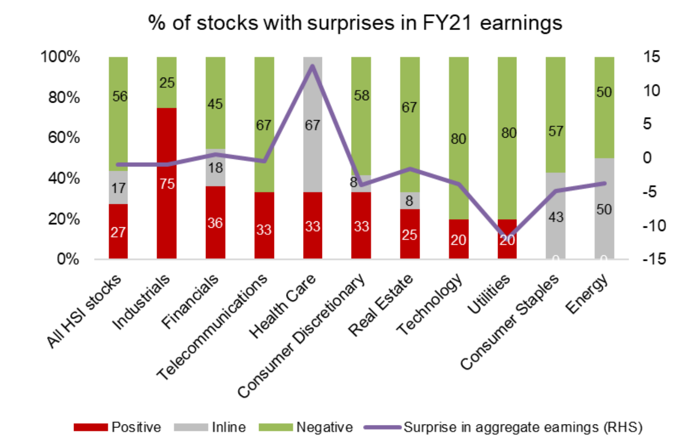


Source: Bloomberg, CMBIGM

Half of HSCI constituents reported earnings miss in FY21

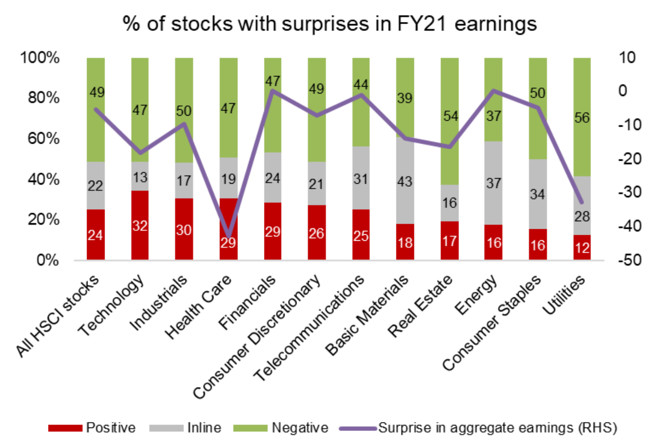
Secondly, we look at how many stocks reported earnings beat or miss in FY21 annual results, and how each industry fared versus consensus. In Fig. 3-4, we rank each sector by their proportions of earnings beats, with the best sector on the left.

Figure 3: HSI sectors' FY21 earnings surprises



Source: Bloomberg, CMBIGM

Figure 4: HSCI sectors' FY21 earnings surprises



Source: Bloomberg, CMBIGM

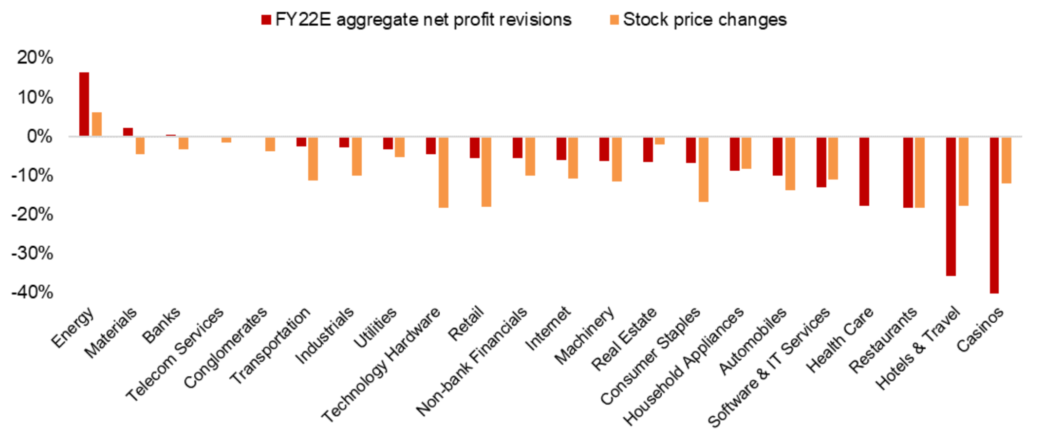
Observations / thoughts on FY21 earnings:

1. Among the 66 HSI constituents, 37 stocks (56% of total) reported a miss in FY21 earnings, but aggregate earnings were only 1% lower than consensus.
2. Half of those 500+ HSCI constituents reported a miss in FY21 earnings. On aggregate, reported earnings were 5.2% lowered than consensus.
3. By HSCI sector, only Financials and Energy reported in-line aggregate earnings, while all the other sectors missed.
4. Utilities and Consumer Staples were the most disappointing sectors with the least beats, possibly due to higher cost pressures.
5. Energy and Materials, despite strong earnings growth relatively to other sectors thanks to soaring commodity prices, were among those sectors with the lowest proportion of earnings beats.

Earnings revisions by sector – Commodities up, Consumer down

Thirdly, we examine how FY22E earnings estimates changed after this result season. We classified HSCI constituents into 22 sub sectors, and compared the aggregate changes in FY22E earnings estimates for each sector during this result season (Fig. 5). Market-cap weighted changes in stock prices are shown in parallel to give an idea of to what extent the earnings revisions have been priced in.

Figure 5: FY22E net profit revisions and stock price changes of HSCI constituents (21 Feb to 6 Apr)



Source: Bloomberg, CMBIGM estimates
*Casinos sector's earnings were revised down by 441%, to uncharted area

Observations / thoughts on FY22E earnings revisions:

1. This result season largely overlapped the outbreak of Russia-Ukraine military conflicts, resurgences in COVID-19 in Mainland China and Hong Kong, and the US Federal Reserve's turning more hawkish. As such, the aforementioned FY22E earnings revisions were affected not only by the FY21 results but also some major risks.
2. Energy, Materials and Banks were the only sectors which enjoyed upward revisions in FY22E earnings. Potential supply disruption in commodities due to Russia-Ukraine

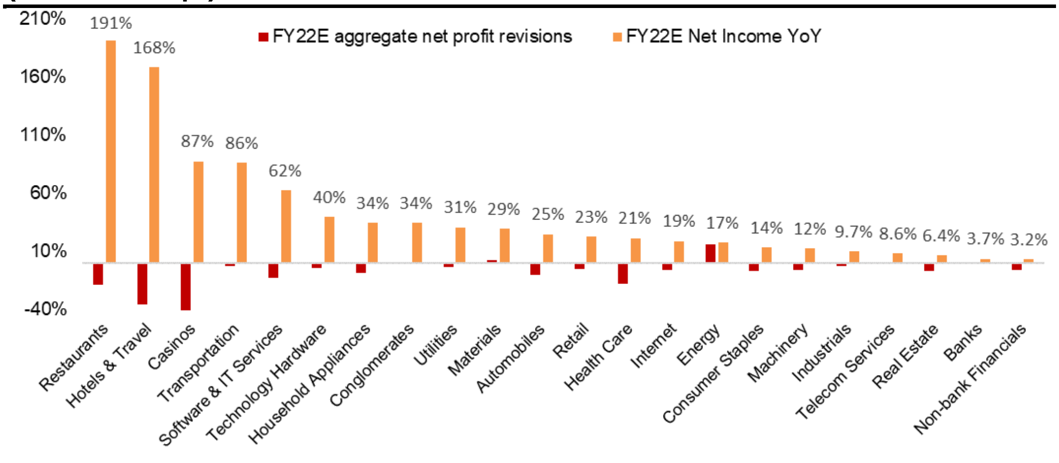
conflicts and sanctions on Russia, higher inflation and therefore higher interest rate outlook were the major forces driving up these sectors' earnings estimates.

3. Sectors which suffered the worst earnings revisions were Casinos, Hotels & Travel and Restaurants, all are highly sensitive to the recent COVID-19 outbreak in Mainland China and HK.
4. Several sectors on the right-hand side of Fig. 3 (i.e. suffered larger FY22E earnings cut) were negatively affected by potentially higher raw materials costs (Consumer Staples) and component shortages (Automobiles, Household Appliances).
5. Some of those sectors which had much larger drops in share prices than earnings estimates include Consumer Staples, Machinery, Technology Hardware, Retail. This means these sectors suffered derating along with earnings cuts. Once the risks of geopolitical tension and COVID-19 outbreak ease, these sectors may have larger room of upward rerating.

FY22E earnings growth by sector

Lastly, we turn to the FY22E earnings growth of each sector. The industries which are expected to post the biggest earnings growth are, perhaps unsurprisingly, those which have been hardest hit by COVID-19 over the past two years, and thus had low earnings bases or even losses (Hotels & Travel, Casinos) in FY21.

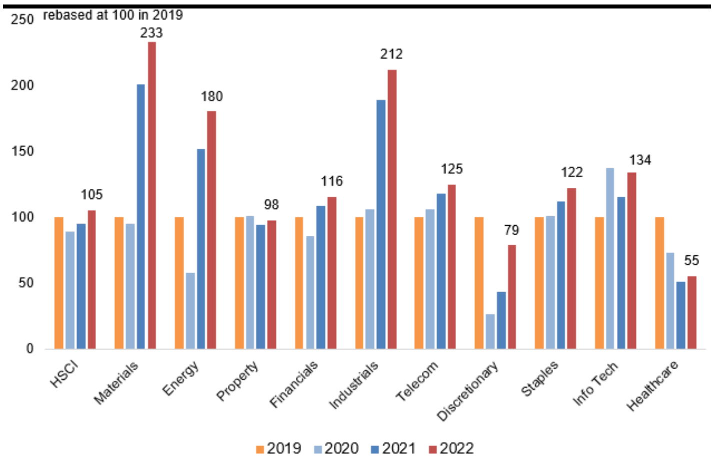
Figure 6：FY22E net profit revisions and stock price changes of HSCI constituents (21 Feb to 6 Apr)



Source: Bloomberg, CMBIGM estimates

We can see from Fig. 7 that, Consumer Discretionary has remarkably low earnings base in FY20 & FY21. Even with FY22E to rebound strongly, their earnings would still be lower than pre-pandemic (FY19) level.

Figure 7: Yearly earnings trend by HSCI sector



Source: Bloomberg, CMBIGM estimates

Sectors views

■ **Upside in Internet as earnings growth is bottoming out**

We expect Internet sector's earnings to start improving in Q2. Sentiment and valuation may also improve after pricing in policy risks for more than a year, as China called for prudence in launching any policies which might impact capital markets, and modified rules to allow US regulators to gain more access to auditing reports of Chinese companies listed in the US. In other words, regulatory risks and delisting risks tend to decrease.

■ **Infrastructure to benefit from more pro-growth policies**

Infrastructure-related sectors such as Construction Machinery & Building Materials could be boosted by a speed up in infrastructure spending, as China vowed to speed up the issuance of government special bonds and infrastructure project construction in Q2-Q3.

■ **Consumer Staples leaders with strong pricing power**

In recent months, costs pressure has been a concern for downstream sectors such as Food & Beverages. For industry leaders that have stronger pricing power (e.g. leaders in Dairy and Beer sectors), the concern might be overdone, as we pointed out that Consumer Staples' drops in share prices have been larger than earnings estimates cuts. A potential catalyst is ceasefire between Russia and Ukraine, which could alleviate raw materials supply and costs concerns.

■ **Energy / Metals might underperform**

We see risks of profit-taking on commodity stocks, as optimism of Russia-Ukraine ceasefire is building up and the US Fed's policy tightening may also bring downward pressure on commodity prices.

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