Q4 TSX Earnings Update

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A Two-Speed Earnings Recovery

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It's now just past the midpoint of the Q4 TSX reporting season. Profit growth in the resource-levered energy and materials groups remains buoyant. Momentum in other sectors—particularly those susceptible to C$ or energy-cost pressures—continues to fade, however. Slackening non-resource earnings growth suggests the high C$ may be impairing earnings prospects more than is widely recognized, warranting caution on some key market groups:

- Approximately 120 TSX Composite members have released earnings for Q4 to date. The "blended consensus"—combining actual results with First Call estimates for firms that have not as yet reported—points to a rise in operating earnings of around 24% (Chart 1, left) for the quarter on a year earlier, a bit below our earlier expectation. That follows Q3's 38% advance, implying a 32% increase for 2004 as a whole.

- We expect earnings growth to slow to a below-consensus 10% pace in 2005 as drag from a still-overvalued C$ and pressure on commodity prices from decelerating global growth hit home (Chart 1, right).

- As in Q3, the major resource-levered groups continue to contribute disproportionately to earnings momentum. Figures for the nearly half of energy group members who have reported for Q4 point to a 43% rise in earnings year-on-year (up from Q3's 37% pace) (Table 1). Upstream producers appear to be showing about twice that growth, with a larger proportion of firms overall topping the consensus than in recent quarters.

- Although a moderating global economy creates longer-term uncertainty, the materials group clearly also rounded out 2004 on a strong note. Q4 earnings for the quarter are likely to be up by about 130% year on year led by diversified mining and steels. Gains in those sectors should offset continued weakness in the forestry sector in the face of C$ pressures and growing electronic competition with print.

Chart 1

Earnings Growth Slackens (L); C$, Weaker Non-Energy Resource Prices Will Weigh (R)

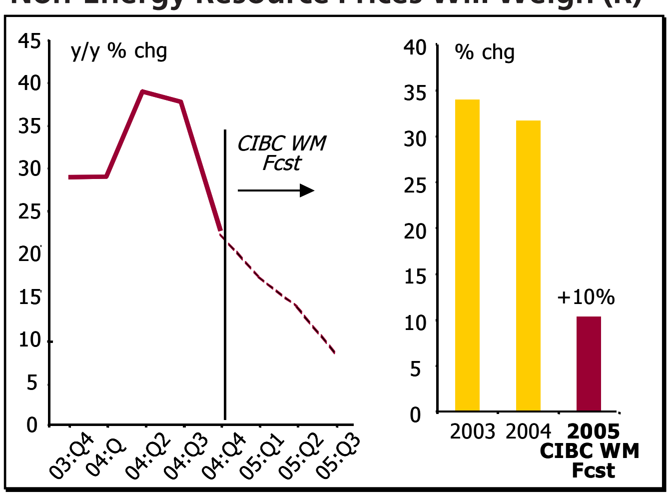


Table 1

TSX - Earnings Outlook & Forward PE

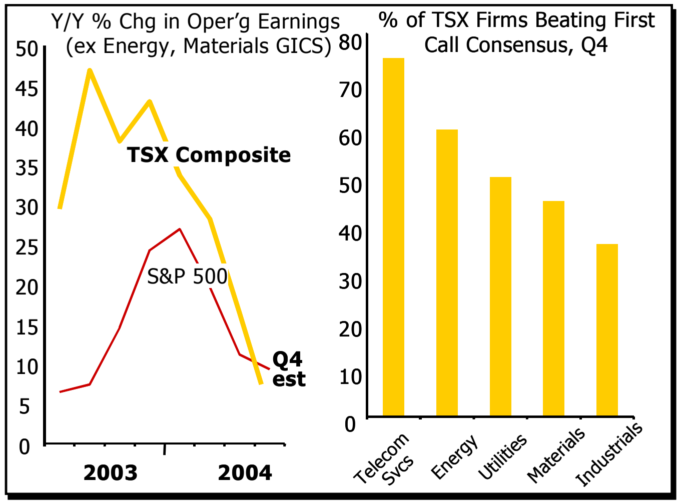
	Operating Earnings (y/y % chg)			4-qtr Fwd PE	
	2004	2005 (CIBC WM)	**2004:Q4 "Blended" Consensus**	Latest	Last 10 yrs.
Energy	20.1	28.0	**43.0**	13.3	13.0
Materials	301.6	3.0	**130.7**	18.8	27.5
Industrial	10.9	-1.5	**34.2**	20.0	15.6
Cons. Discr.	28.7	-4.3	**5.5**	23.0	18.6
Cons. Staples	12.1	4.0	**12.4**	21.2	17.0
Health Care	18.9	11.7	**67.2**	27.2	49.7
Financials	18.9	5.9	**11.5**	14.5	10.9
Info Tech	59.5	2.1	**-30.2**	30.3	32.3
Telecom.	23.6	13.4	**32.2**	14.6	34.7
Utilities	1.2	9.4	**-6.7**	16.9	13.9
TSX Composite	32.4	10.1	**24.3**	16.3	17.9

Source: CIBC WM, Thomson/First Call, Bloomberg L.P.

**Note: Nov, Dec or Jan quarter-end. Earnings excl. non-recurrent items and are after interest expense and tax. First Call Consensus estimates are used for for firms that have not reported through Feb. 22.*

Chart 2

Non-Resource Earnings Lose Steam (L), Energy, Telecoms Firms Beat Consensus (R)



- Outside of resources, TSX earnings appear headed for a muted 8% rise in Q4 (Chart 2, left). That's well below the pace for comparable New York-listed large cap stocks, suggesting that the soaring loonie is bringing what to date has been a higher-flying TSX earnings recovery back to earth. While earnings in the telecom sector—which benefits from a firmer C$ thanks to savings in imported component costs—rose, earnings fell or trailed expectations in other key sectors. Stiff price competition and uneven US consumer demand added to pressure on tech earnings.
- Energy and telecom services firms, both among our recommended overweights, have done well relative to expectations with 75% and 60% respectively of reporters in Q4 beating analysts' earnings expectations (Chart 2, right). In contrast, only 45% and 36% of the materials and industrial firms that have reported to date have topped the consensus, suggesting valuations in those sectors already build in most, if not all, of any near-term upside for profits.