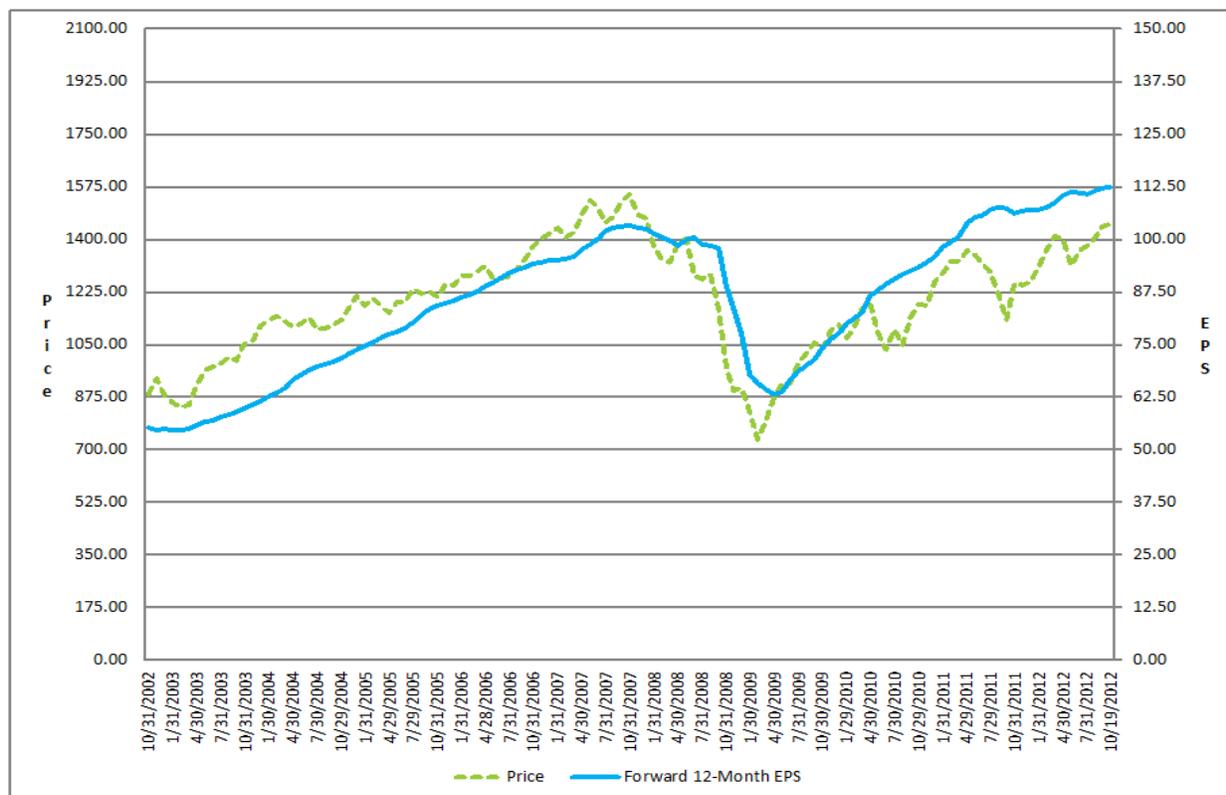


### Key Metrics

- + **Earnings Scorecard:** Of the 98 companies that have reported earnings to date for Q3 2012, 70% have reported earnings above the mean estimate, but only 42% have reported sales above the mean estimate.
- + **Earnings Growth:** The blended earnings growth rate for Q3 2012 is -2.3%. If -2.3% is the final growth rate for the quarter, it will mark the end of the eleven-quarter streak of earnings growth for the index.
- + **Earnings Revisions:** On September 30, the blended earnings growth for Q3 2012 was -2.9%. The Financials sector has witnessed the largest improvement in projected earnings growth since the end of the quarter.
- + **Earnings Guidance:** For Q4 2012, 21 companies have issued negative EPS guidance and 1 company has issued positive EPS guidance.
- + **Valuation:** The current 12-Month forward P/E ratio is 13.0. This P/E ratio is below the average forward 12-Month P/E ratio over the past 10 years (14.3).

S&P 500 Forward 12-Month EPS vs. Price: 10-Year



All data published in this report is available on FactSet. Please contact media\_request@factset.com or 1-877-FACTSET for more information.

## Topic of the Week:

### Lowest Percentage (42%) of Companies Beating Sales Estimates since Q1 2009

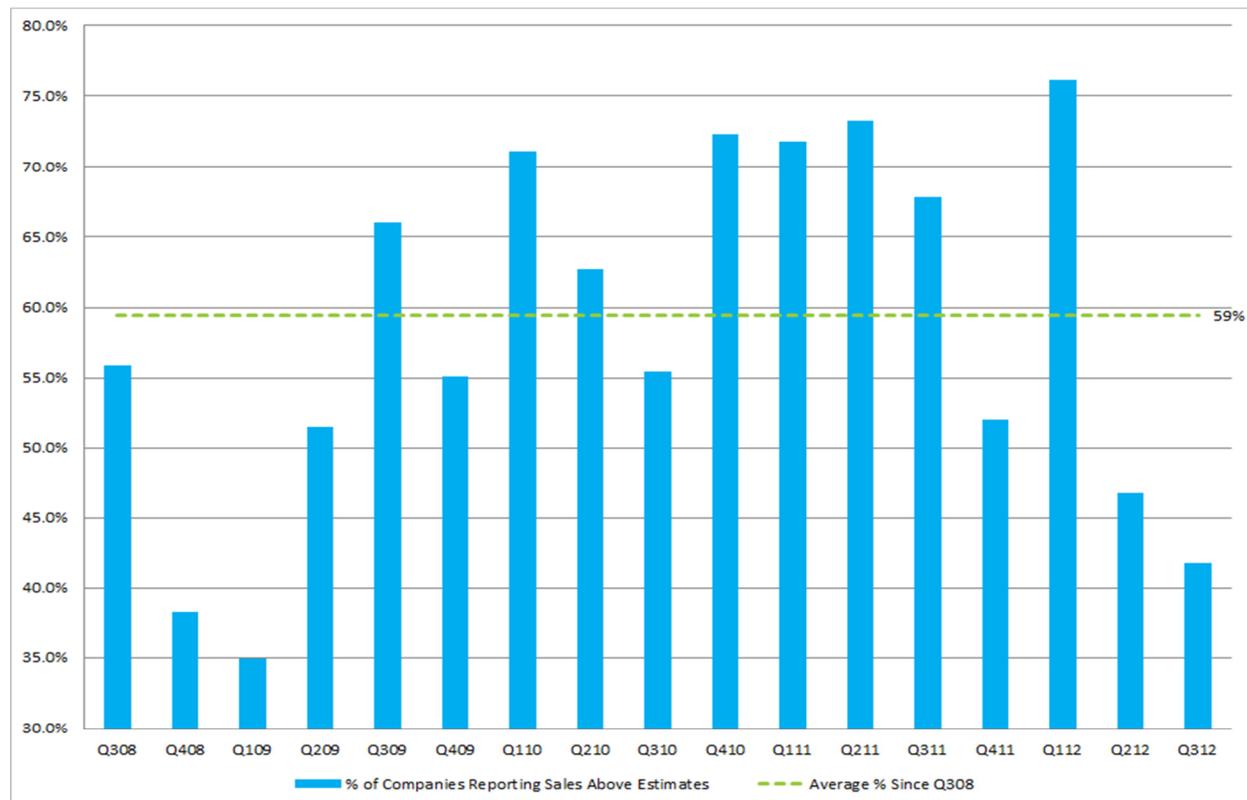
To date, 98 companies in the S&P 500 have reported revenues and earnings for the third quarter. Of these 98 companies, only 42% have reported actual sales above the mean estimate. This percentage is well below the average for this stage of the earnings season (20 days after the end of the quarter). Over the past four years on average, 59% of companies have reported sales above estimates at this point in time.

In fact, this is the lowest percentage of companies to report sales above estimates at this point in the earnings season since Q1 2009 (35%). During the Q2 2012 earnings season, 47% of companies had reported sales above estimates on April 20th.

Will these percentages improve? Over the past four years on average, the final percentage of companies reporting sales above estimates (56%) has been about three percentage points lower than the average percentage at this stage of the earnings season (59%). The final percentage for the Q2 2012 (42%) quarter was about five percentage points below the percentage (47%) at this same point in time during the Q2 2012 earnings season.

It is interesting to note that the market has not typically reacted negatively in recent earnings seasons when the percentage of companies reporting sales above estimates has been below average. Since 2009, there have been five quarters (Q2 2009, Q4 2009, Q3 2010, Q4 2011, and Q2 2012) in which the percentage of companies reporting sales above estimates was below the average of 59% at this stage of the earnings season. However, the S&P 500 finished higher the month after the end of the quarter in four of these five months. The trend has continued to date during the Q3 2012 earnings season, as the index is up 0.6% since September 30 (based on Thursday's close).

% of Companies Reporting Sales above Estimates through First 20 Days after End of Qtr.



## Q3 2012 Earnings Season: Overview

### Companies Beating EPS Estimates but Missing Sales Estimates

#### Large Upside Earnings Surprises Reported By Companies in the Financials Sector

This past week marked the first peak week of the Q3 2012 earnings season. At this stage of the earnings season, the percentage of companies reporting earnings above expectations is in-line with recent averages, while the percentage of companies reporting sales above estimates is well below recent averages.

Overall, 98 companies have reported earnings to date. Of these 98 companies, 70% have reported actual EPS above the mean EPS estimate and 30% have reported actual EPS below the mean EPS estimate. Over the past four quarters on average, 70% of companies have reported actual EPS above the mean EPS estimate.

At the sector level, the Consumer Staples (90%) and Health Care (82%) sectors have the highest percentages of companies reporting earnings above estimates (with at least five companies reporting), while the Information Technology sector (57%) has the lowest percentage of companies reporting earnings above estimates.

In aggregate, companies are reporting earnings that are 6.2% above expectations. Over the last four quarters on average, actual earnings have surpassed estimates by 4.7%. Companies in the Financials sector (11.9%) are reporting the largest aggregate differences between actual earnings and estimated earnings, including Travelers (+35.5%) and Goldman Sachs (+30.0%).

#### Lowest Percentage (42%) of Companies Beating Sales Estimates since Q1 2009

In terms of revenues, 42% of companies have reported actual sales above estimated sales and 58% have reported actual sales below estimated sales. This is the lowest percentage of companies reporting sales above estimates at this stage of the earnings season since Q1 2009 (see page 2).

At the sector level, the Industrials (17%) and Health Care (18%) sectors have the lowest percentages of companies reporting sales above estimates (with at least five companies reporting), while the Financials sector (64%) has the highest percentage of companies reporting sales above estimates.

In aggregate, companies are reporting sales that are 1.0% below expectations. Over the previous four quarters on average, actual sales have exceeded estimates by 0.4%.

### Upside EPS Surprises in Financials Sector Drive Improvement in Earnings Growth

The blended earnings growth rate for the third quarter is -2.3% this week, above last week's growth rate of -3.3%. Upside earnings surprises from companies in the Financials sector (including Bank of America, Goldman Sachs, and Citigroup) were mainly responsible for the increase in the blended earnings growth rate during the week. Bank of America reported actual EPS of \$0.00, compared to the mean EPS estimate of -\$0.07. Goldman Sachs reported actual EPS of \$2.85, compared to the mean EPS estimate of \$2.19. Citigroup reported actual EPS of \$1.06, compared to the mean EPS estimate of \$0.96. Overall, the blended earnings growth rate for the Financials improved to 13.3% from 8.4% during the week.

Since the end of the third quarter (September 30), the earnings growth rate for the index has improved to -2.3% from -2.9%. Five of the ten sectors have seen an increase in their earnings growth rates over this time frame, led by upside earnings surprises from companies in the Financials sector. Upside earnings surprises from companies in the Health Care sector, and upward revisions to earnings estimates for companies in the Energy sector have also contributed to the overall increase in earnings growth for the index.

## Earnings Decline (-2.3%) for Q3 Led By Commodity Sectors: Materials and Energy

The blended earnings growth rate for Q3 2012 is -2.3%. If this is the final growth rate for the quarter, it will mark the end of the streak of eleven consecutive quarters of earnings growth for the index.

Overall, six of the ten sectors are reporting a year-over-year decline in earnings for the quarter. Of these six sectors, the Materials and Energy sectors have the lowest earnings growth rates. On the other hand, the Financials sector is reporting the highest earnings growth rate of all ten sectors.

### Energy & Materials Sectors: Earnings Decreases Reported Despite Rise in Commodity Prices

The Materials sector has the lowest earnings growth rate (-21.8%) and the second lowest revenue growth rate (-4.5%) of all ten sectors. Ten of the twelve sub-industries in this sector are reporting a year-over-year decrease in earnings, led by the Aluminum (-80%), Steel (-59%), and Diversified Metals & Mining (-33%) sub-industries.

The Energy sector has the second lowest earnings growth rate (-20.2%) and the lowest sales growth rate (-18.0%) of all ten sectors. Six of the seven sub-industries in the sector are predicted to see a decline in earnings, led by the Coal & Consumable Fuels (-99%) and Oil & Gas Exploration & Production (-36%) sub-industries. The Energy sector is also the largest contributor to the decrease in earnings for the index. If the Energy sector is excluded, the growth rate for the index would improve to 1.0%.

Although many commodities recorded an increase in price during the course of the third quarter, the prices for the quarter were still below year-ago levels. This year-over-year decline in prices is a contributing factor to the earnings declines being reported by many of the companies in these two sectors.

*“Third quarter 2012 revenue was \$5.8 billion, down 9 percent compared with third quarter 2011, primarily due to a 17 and 20 percent year-on-year respective decline in the realized metal price and realized alumina price.” –Alcoa (Oct. 9)*

*“Average sales price per ton decreased 3% from the second quarter of 2012 and decreased 8% from the third quarter of 2011.” –Nucor (Oct. 18)*

However, it is interesting to note that the average prices of both Brent Crude (ICE - \$/bbl) and Crude Oil (NYM - \$/bbl) were almost equal to average year-ago levels. The average price of Brent Crude for Q3 2012 was \$109.34, slightly below the average price of \$111.96 in Q3 2011. The average price of Crude Oil for Q3 2012 was \$92.22, slightly above the average price of \$89.55 in Q3 2011. Based on these numbers, it does not appear that oil prices are a major contributor to the expected earnings and revenue declines for companies in the Energy sector, or analysts have been slow to revise estimates upward to reflect the price changes. There have been some upward revisions to the estimates for companies in this sector in recent weeks.

### Financials Sector: Broad-Based Earnings Growth in Sector

The Financials sector has the highest earnings growth rate (13.3%) of all ten sectors and is also the largest contributor to earnings growth for the index. If the Financials sector is excluded, the growth rate for the index falls to -5.1%. Despite some high-profile year-over-year declines in earnings reported by companies such as Bank of America, earnings growth is broad-based across the sector. Fourteen of the 19 sub-industries are reporting earnings growth. Eleven of the these fourteen sub-industries are reporting double-digit earnings growth, led by Regional Banks (50%), Real Estate Services (39%), Insurance Brokers (39%), Specialized REITs (35%), Residential REITs (29%), Property & Casualty Insurance (25%) and Diversified Banks (20%). On the other hand, the Other Diversified Financial Services sub-industry reported the lowest earnings growth (-36%) of all 19 sub-industries. However, it is important to note that the sector is only reporting revenue growth of 0.5%, which is the third lowest sales growth rate in the index.

**Revenue Growth: -0.6%**

In terms of revenues, the blended growth rate stands at -0.6%, down from an estimate of 0.0% at the end of the quarter (September 30). Despite the low overall revenue growth rate for the index, eight of the ten sectors are reporting sales growth for the quarter. The only two sectors reporting a decline in sales are the Energy (-18.0%) and Materials (-4.5%) sectors.

The Energy sector is the largest contributor to the decline in sales for the index. If the Energy sector is excluded, the blended revenue growth rate would improve to 2.9%.

It is interesting to note that the year-over-year decline in sales (-0.6%) is smaller than the year-over-year decline in earnings (-2.3%) for Q3 2012. In fact, nine out of ten sectors in the index are reporting higher sales growth than earnings growth for the quarter. The only sector reporting higher earnings growth (13.3%) than sales growth (0.5%) is the Financials sector. Given that sales growth does not appear to be translating to earnings growth for companies in a number of sectors, this could mean that companies faced higher costs in the third quarter.

*"Gross margin declined 80 basis points to 43.5 percent. Gross margin continued to benefit from pricing actions and product cost reduction initiatives, however, this was more than offset by higher input costs, primarily materials and labor." –Nike (Sep. 27)*

**Global Economic Slowdown: Europe, F/X Rates, and China**

Last quarter, many companies in the index reported lower revenue growth outside of the U.S. relative to recent years due to weak economic growth in Europe, less favorable foreign exchange rates, and slower economic growth in emerging markets (China). These conditions will likely continue to have a negative impact on revenue and earnings growth in Q3 2012 as well.

**Europe**

Europe is now reporting a decline in economic growth relative to last year. According to FactSet Economics, the European Union recorded a decline in GDP of 0.3% in Q2 2012, compared to growth of 1.7% in Q2 2011. Companies have commented on the impact of the difficult conditions in Europe on their top and bottom lines in Q3 2012.

*"Having said that, we continue to see headwinds in most of the European countries, and particularly Southern Europe, but also in Central Europe. The headwinds are in different areas." – Johnson & Johnson (Oct. 16)*

**Less Favorable F/X Rates**

The continuing weakness in Europe contributed to another factor that had a negative impact on revenue and earnings growth in Q3 2012: less favorable foreign exchange rates. In 2011, many companies recorded a boost to revenues due to the weakness of the U.S. dollar relative to the Euro and other currencies. However, the ongoing weakness in Europe has led to the dollar gaining strength relative to the Euro over the past year. In Q3 2011, one Euro was equal to about \$1.41 U.S. dollars on average. For Q3 2012, one Euro was equal to about \$1.25 U.S. dollars on average. Companies have commented on the negative impact of foreign exchange rates on sales and earnings in Q3 2012.

*Currency represented a 5% headwind on comparable net revenues and a 7% headwind on comparable operating income in the quarter. –Coca-Cola (Oct.16)*

**China and Emerging Markets**

Economic growth in countries in emerging markets has also been decreasing over the past year. According to FactSet Economics, three of the four "BRIC" countries recorded slower GDP growth during this time. For Q2 2011, China, India and Brazil recorded GDP growth of 9.5%, 9.0% and 3.3%, respectively. By Q2 2012, GDP growth rates for China, India, and Brazil had fallen to 7.6%, 3.0% and

0.3%. For Q3 2012, China recently reported GDP growth of 7.4%. Companies have commented on the negative impact of slowing economic growth in emerging markets on their top and bottom lines in Q3 2012.

*“You know, clearly we have – we saw a softening in the consumer segments. We talked about that when we did the pre-announcement about a month ago, and the surprise there was that China, which had been very strong, turned weak on us...” –Intel (Oct. 16)*

#### **Q4 EPS Guidance: Negative Start**

Of the 22 companies that have issued EPS guidance for the fourth quarter, 21 have issued projections below the mean EPS estimate and just one has issued a projection above the mean EPS estimate. Thus, 95% of the companies that have issued EPS guidance to date for Q4 2012 have issued negative guidance. This percentage is well above the percentage recorded in the previous quarter at this same point in time (82%).

#### **Analysts Lower Forward Projections Slightly, But Still Call for Rebound in Growth in Q4**

Since the end of the third quarter (September 30), analysts have reduced earnings growth expectations for Q4 2012 (to 9.4% from 9.6%), Q1 2013 (to 5.0% from 5.4%), and Q2 2012 (to 8.9% from 9.5%).

Despite the reductions to earnings estimates for Q4 2012, analysts are still calling for substantial increase in earnings growth (9.4%) relative to Q3 2012 (-2.3%). All ten sectors are projected to report earnings growth, led by the Financials (30.0%), Materials (23.1%), Telecom Services (11.5%) and the Consumer Discretionary (10.8%) sectors.

In addition, analysts are calling for slightly higher revenue growth rates in Q4 2012 (3.1%), Q1 2013 (1.4%) and Q2 2013 (3.6%) relative to the current growth rate for Q3 2012 (-0.6%)

#### **Valuation: Forward P/E at 13.0, But Still Below 10-Year Average**

The current forward 12-month P/E ratio for the index is 13.0. This 13.0 P/E ratio is below the prior ten-year average forward 12-month P/E ratio of 14.3, but slightly above the P/E ratio of 12.9 recorded at the start of the fourth quarter (September 30). The P/E ratio is based on Wednesday's closing price of 1460.91 and a forward 12-month EPS estimate of 112.25.

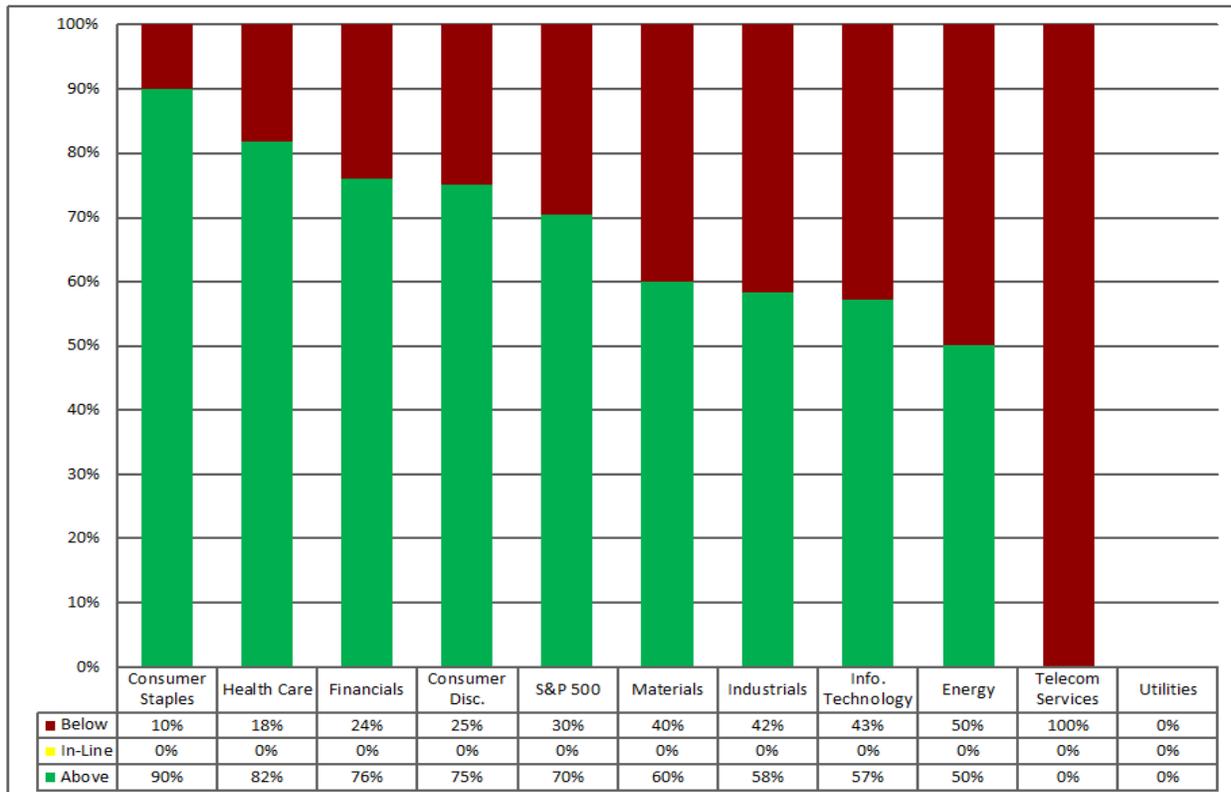
Will there be a return to the 10-year average valuation for the market anytime soon? If there is going to be a return to this average P/E ratio of 14.3, either future estimates will need to decrease, the price of the index will need to increase, or a combination of the two will need to occur.

#### **Companies Reporting Next Week: 156**

The upcoming week marks the second peak week of the Q3 2012 earnings season, as eight Dow 30 components and 156 S&P 500 companies are scheduled to report earnings during the week.

Q3 2012: Scorecard

Q3 2012 Earnings: Above, In-Line, Below Estimates

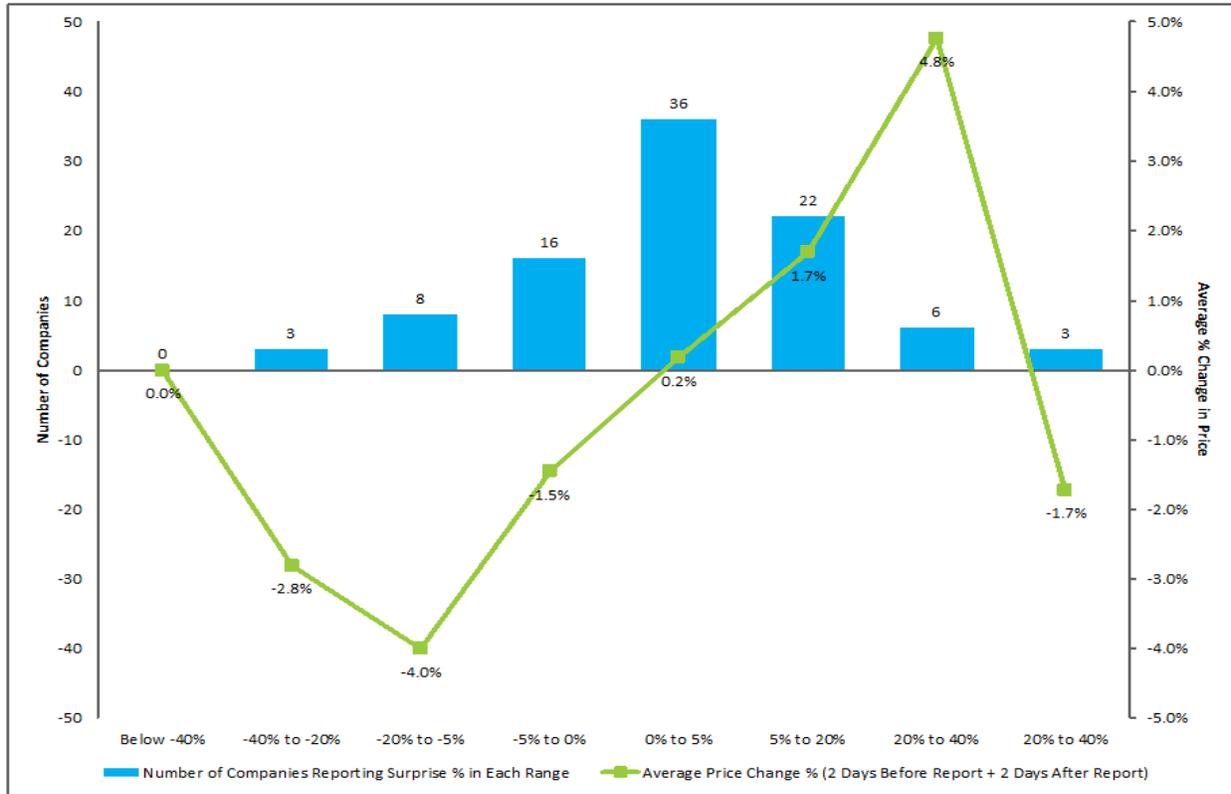


Q3 2012 Revenues: Above, In-Line, Below Estimates

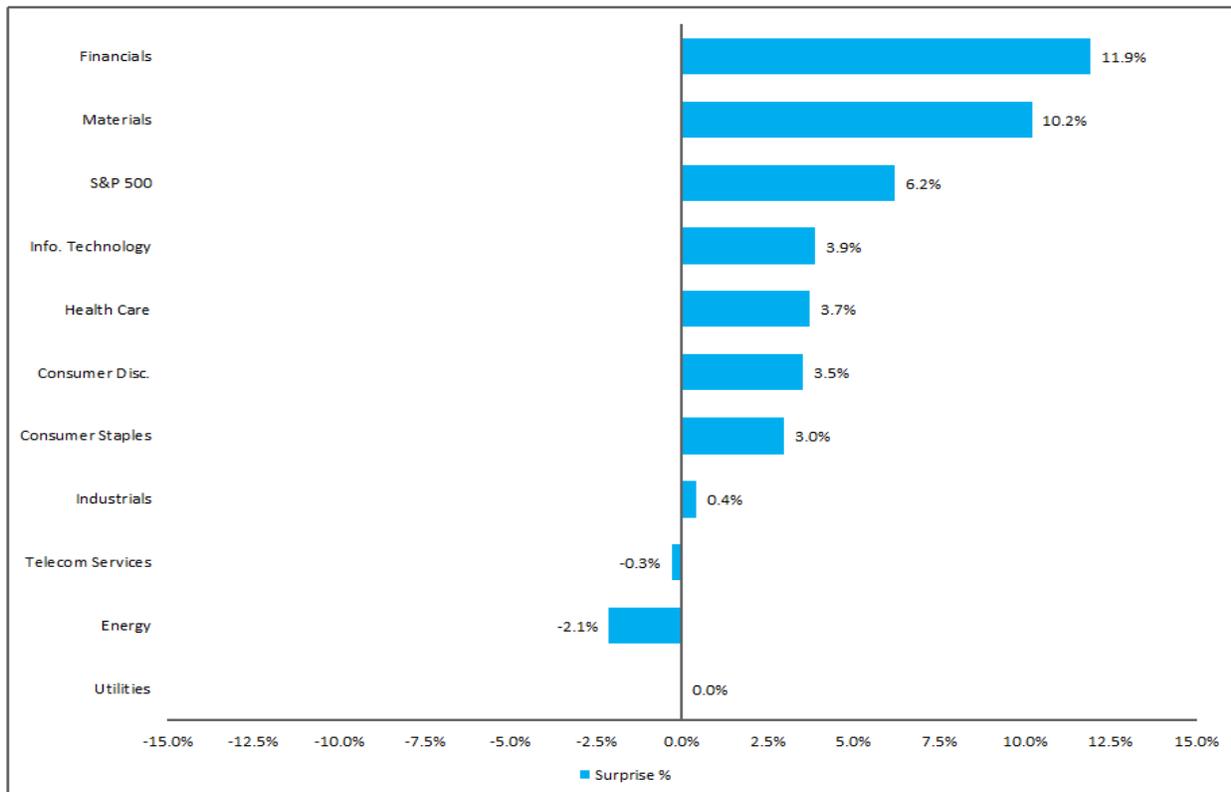


Q3 2012: Scorecard

Q3 2012: Surprise % vs. Average Price Change %

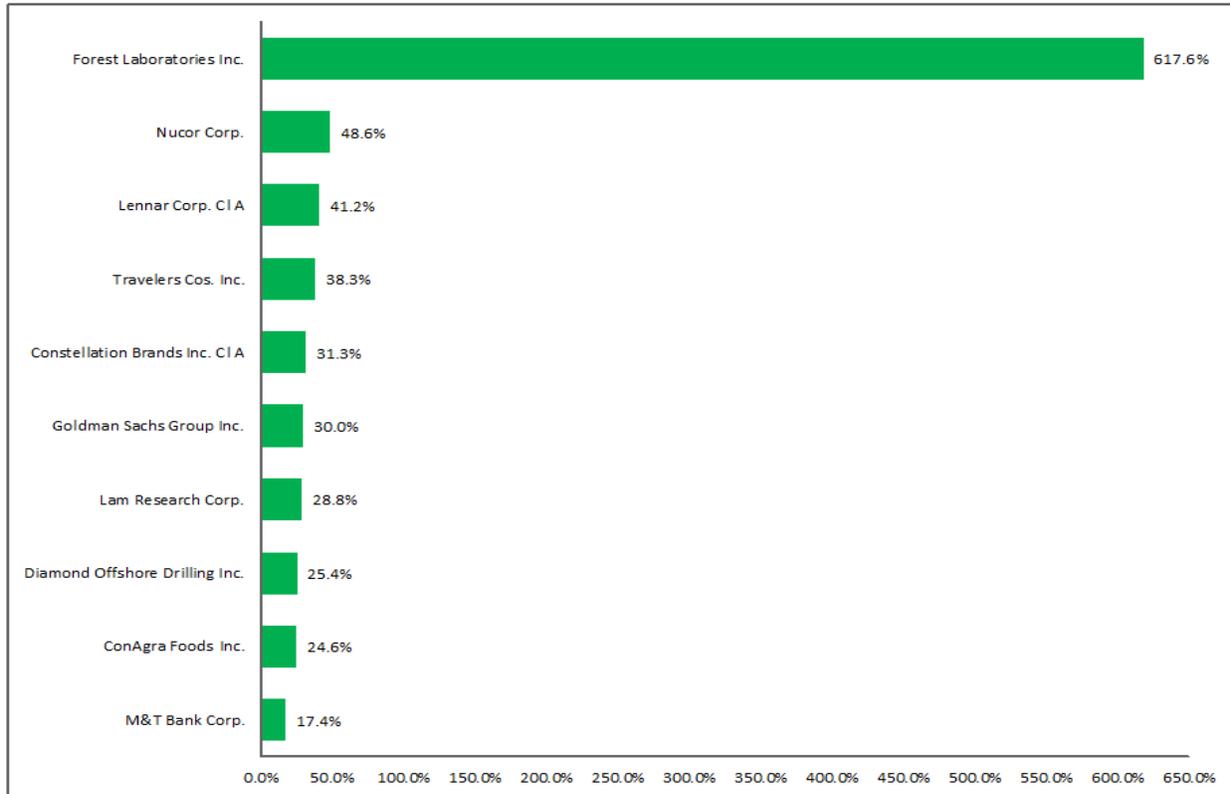


Q3 2012: Sector Level Surprise %

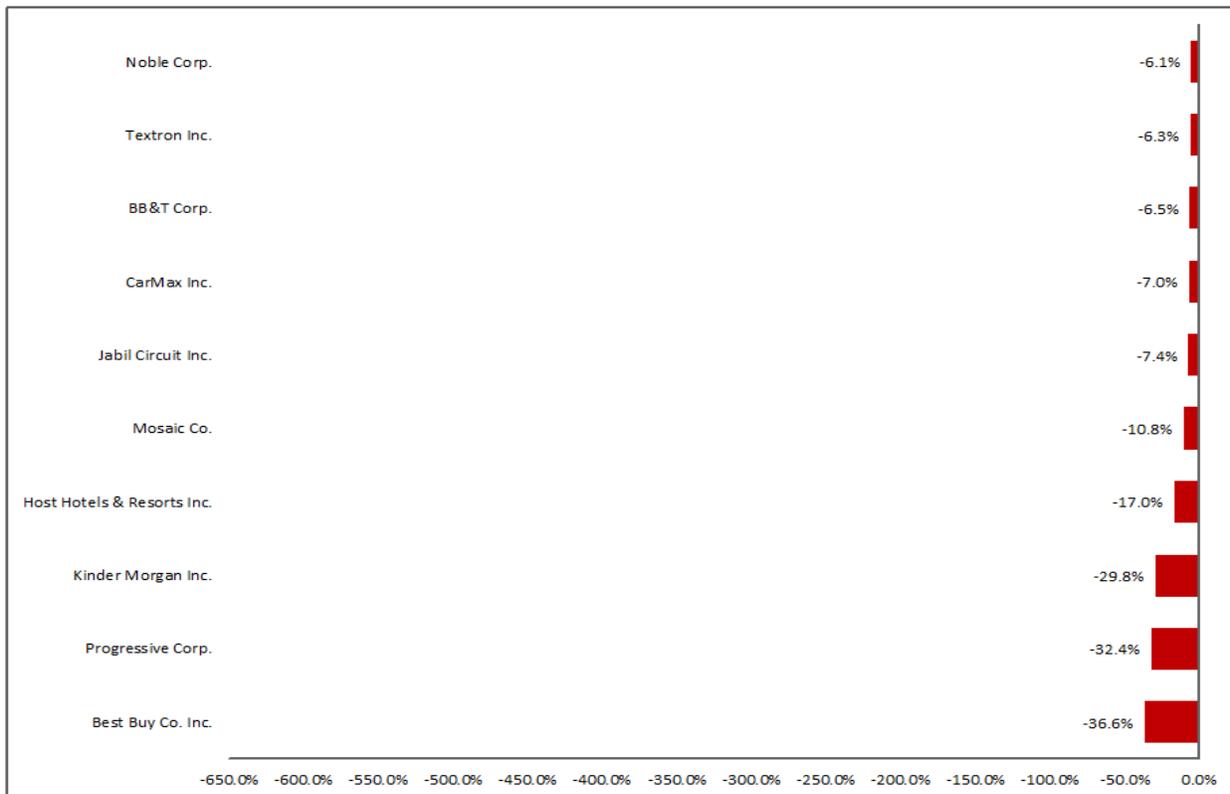


Q3 2012: Scorecard

Surprise %: Top 10 Companies

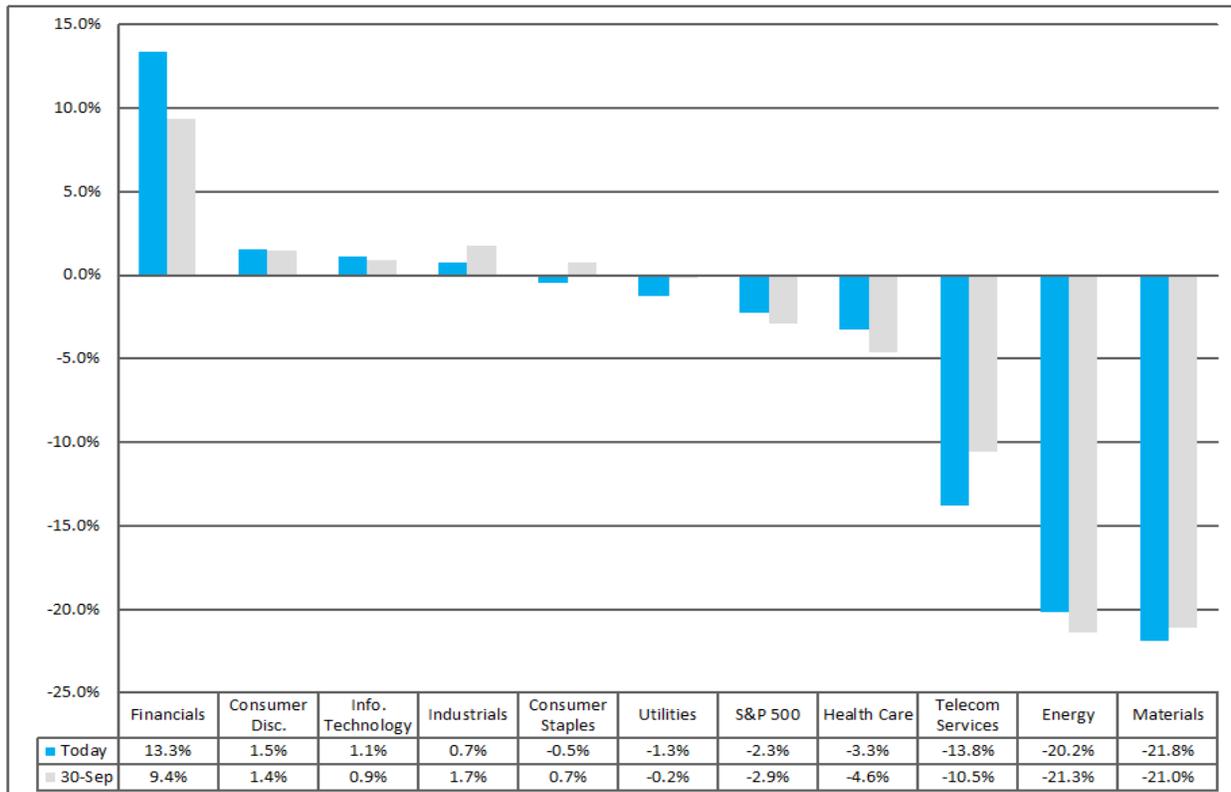


Surprise %: Bottom 10 Companies



Q3 2012: Growth

Q3 2012 Earnings Growth

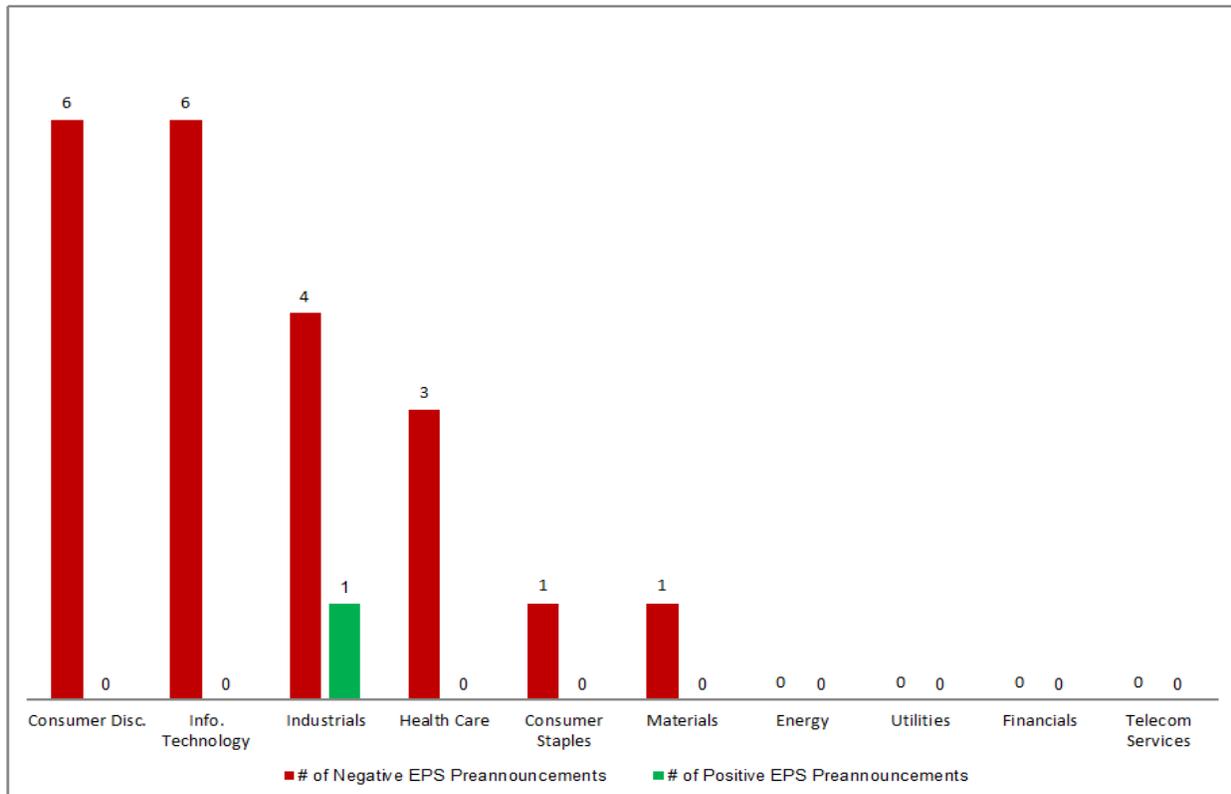


Q3 2012 Revenue Growth



Q4 2012: Guidance

Number of Positive & Negative EPS Preannouncements: Q4 2012

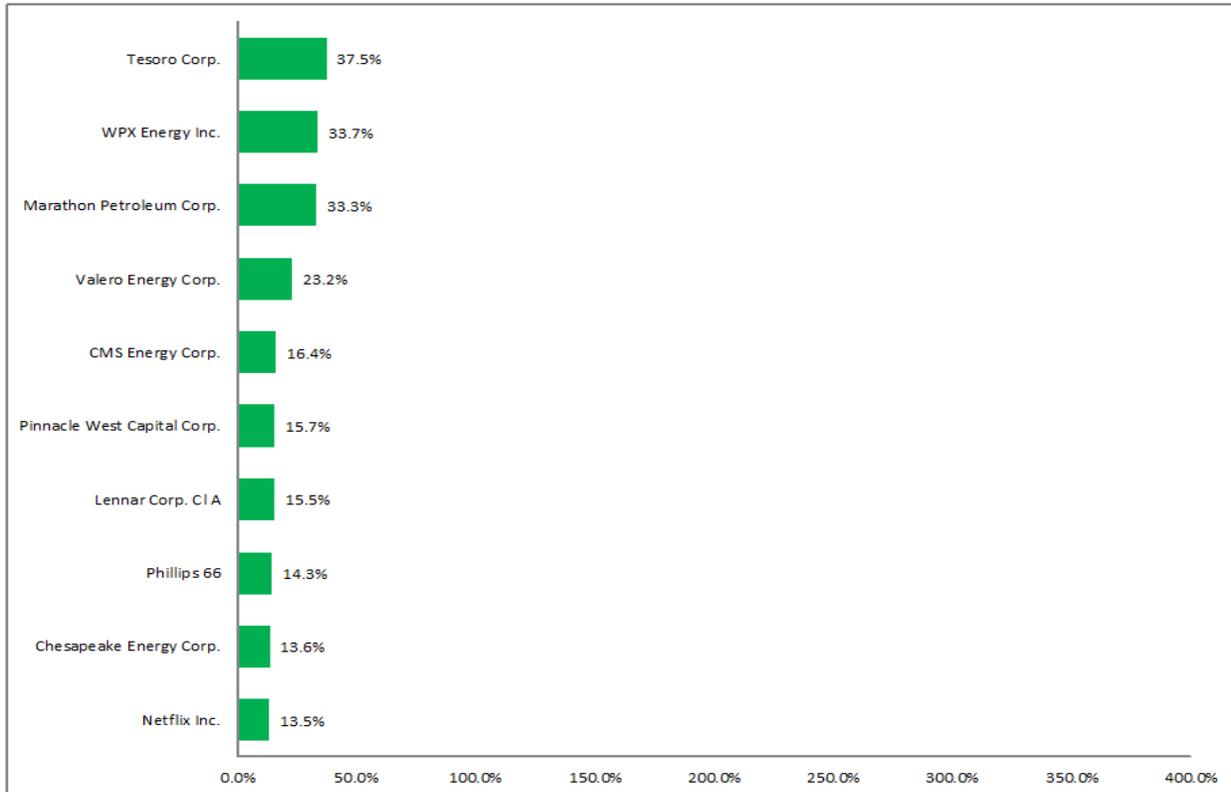


Percentage of Positive & Negative EPS Preannouncements: Q4 2012

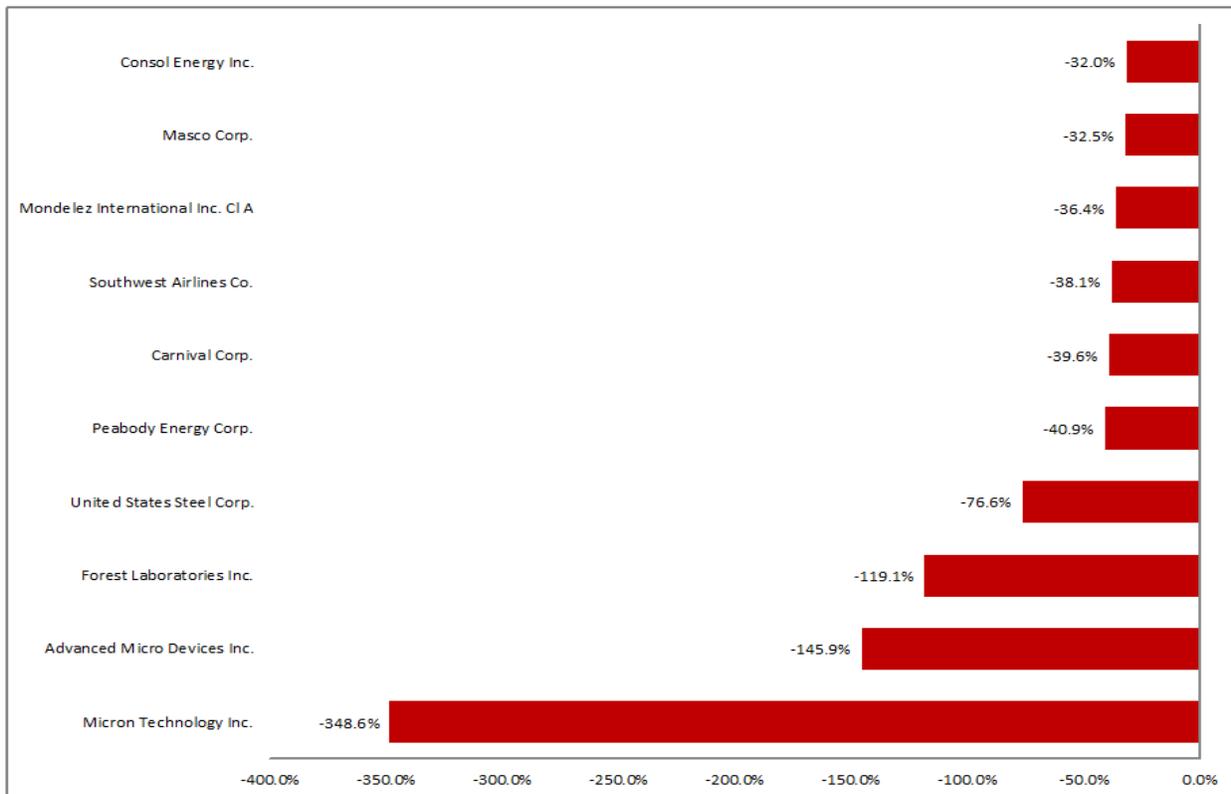


## Q4 2012: EPS Revisions

Highest Upward Change (Trailing 4-Weeks) in Mean EPS Estimate: Top 10 Companies

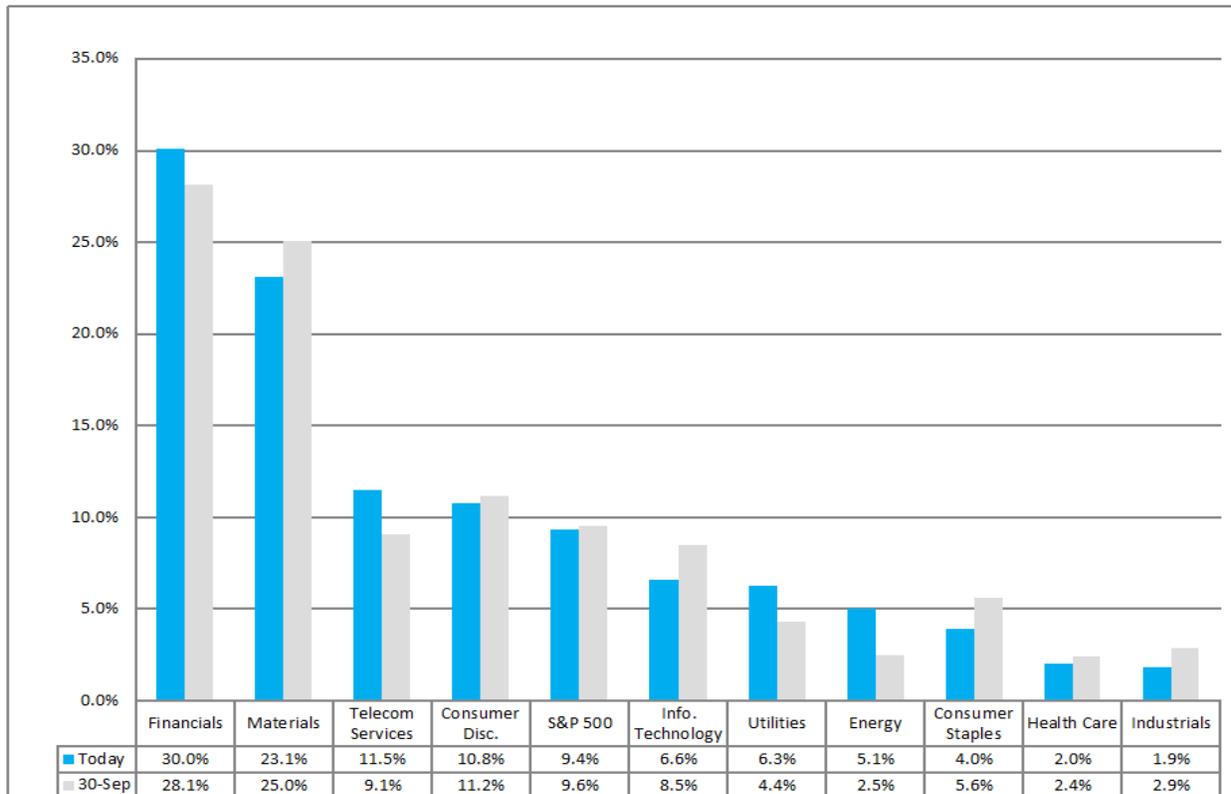


Highest Downward Change (Trailing 4-Weeks) in Mean EPS Estimate: Top 10 Companies

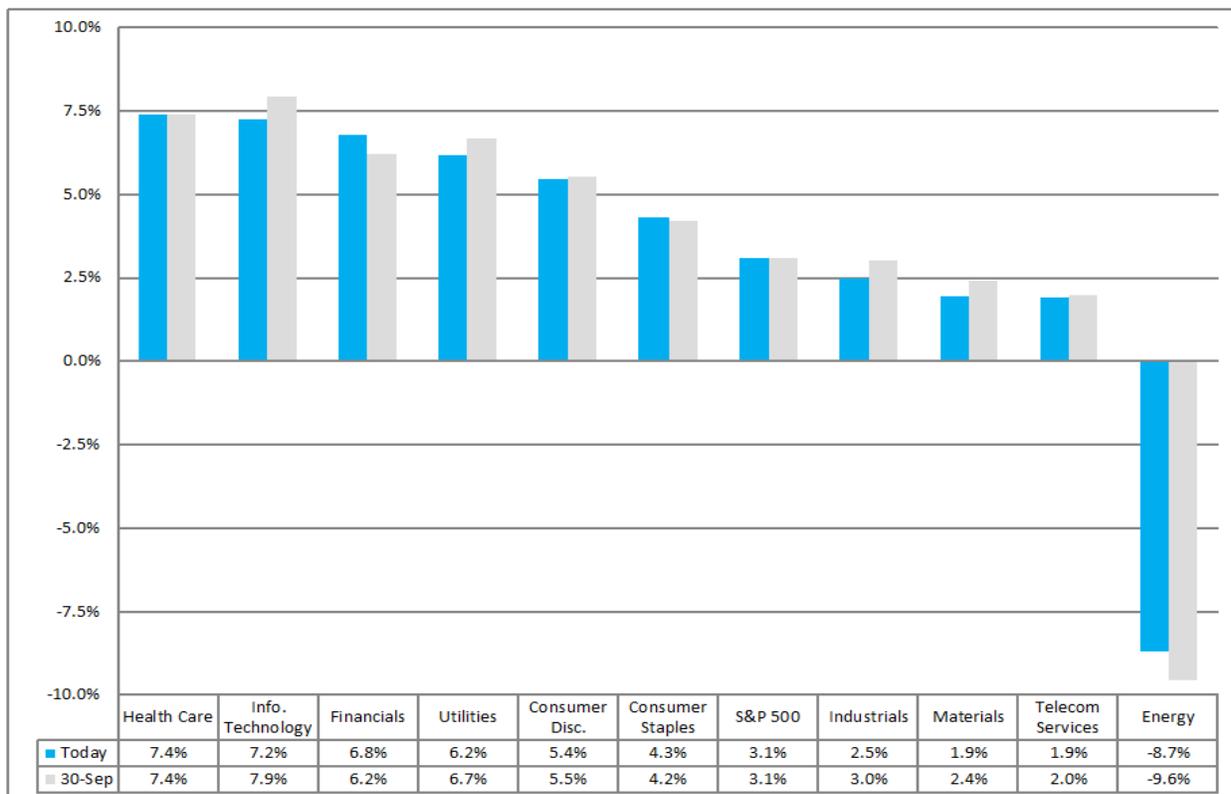


Q4 2012: Growth

Q4 2012 Earnings Growth

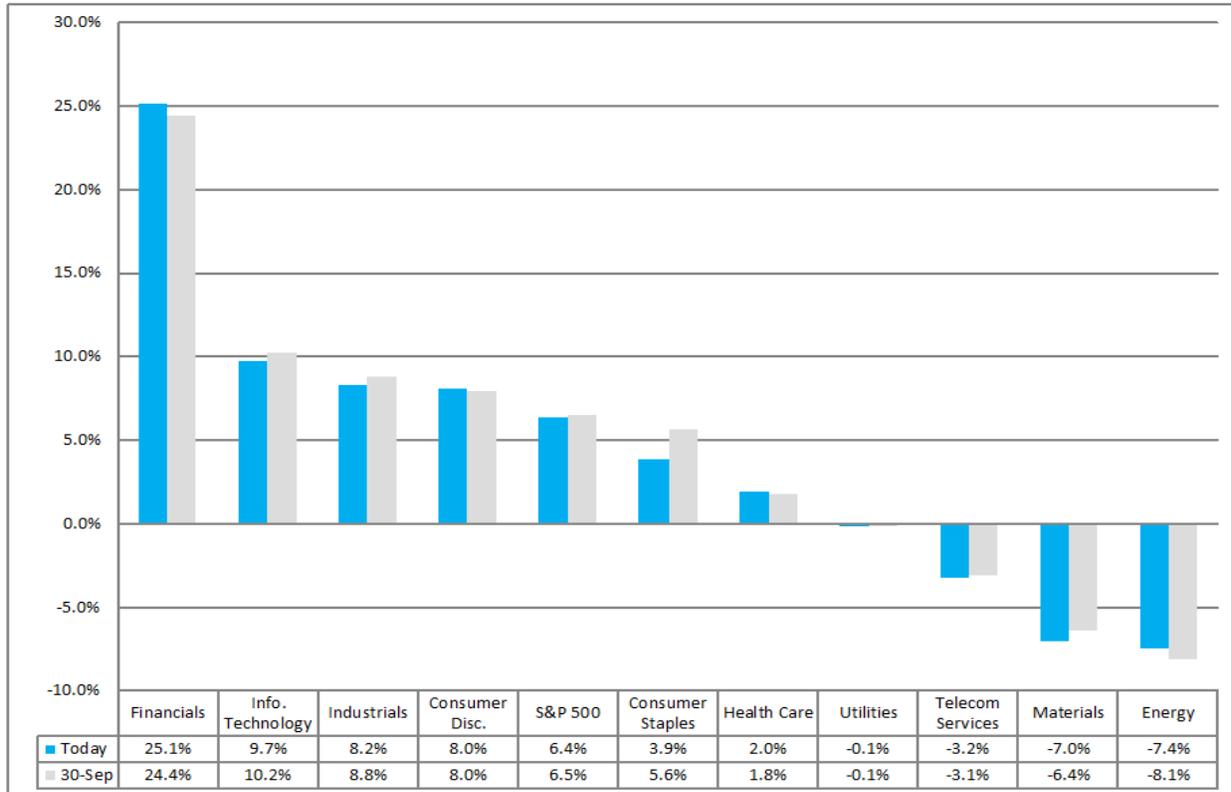


Q4 2012 Revenue Growth

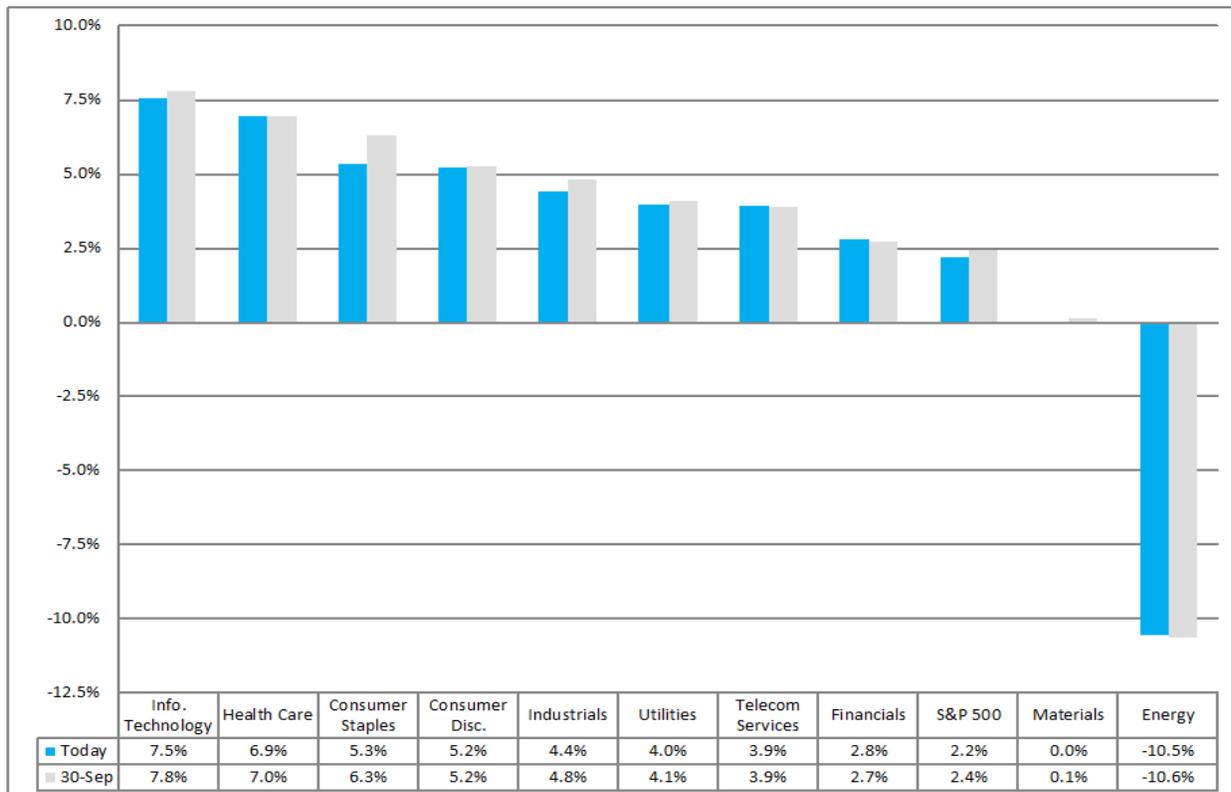


CY 2012: Growth

CY 2012 Earnings Growth

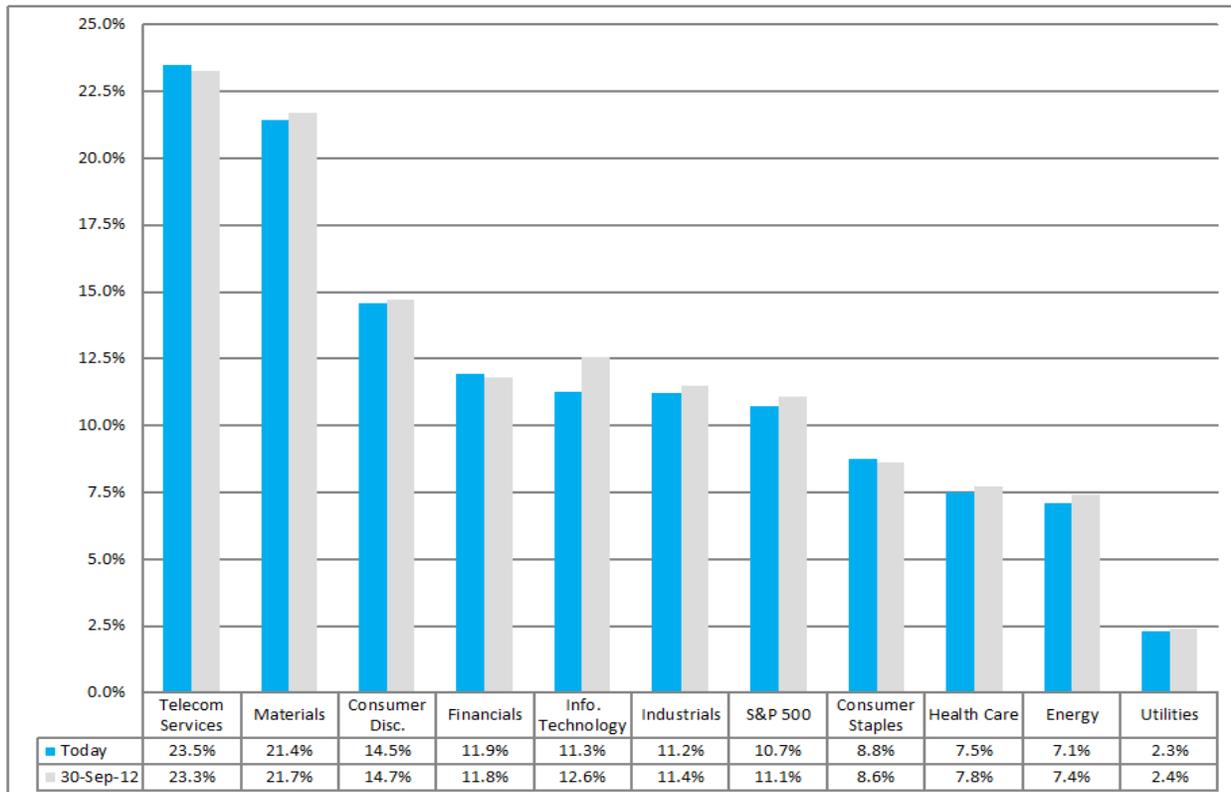


CY 2012 Revenue Growth

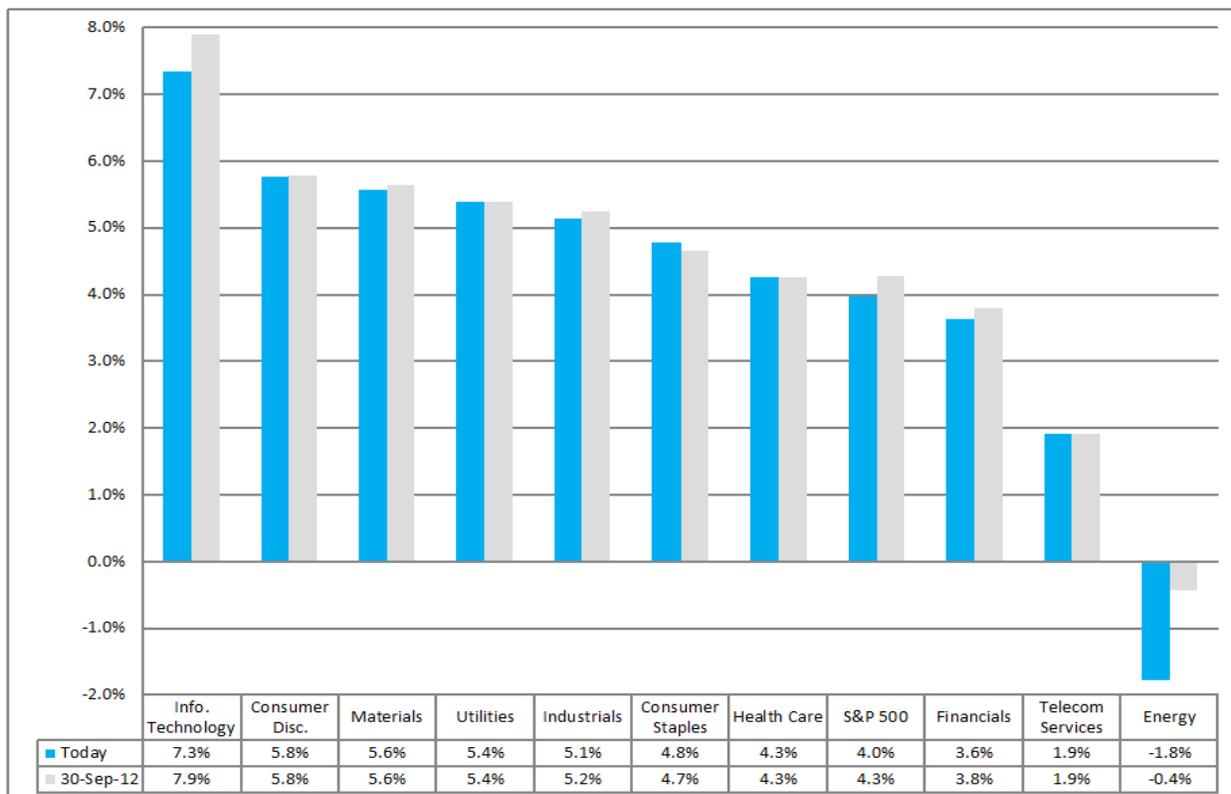


CY 2013: Growth

CY 2013 Earnings Growth

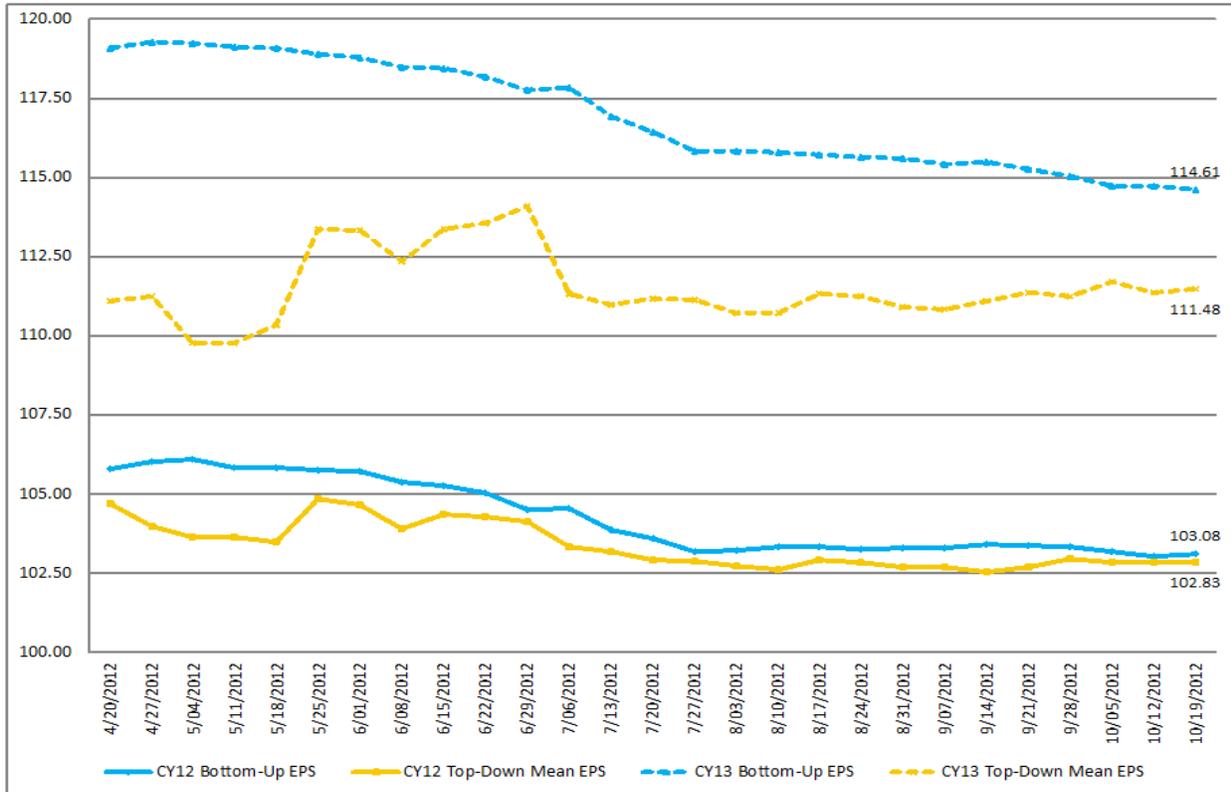


CY 2013 Revenue Growth



### Bottom-up Estimates: Revisions

CY Bottom-Up EPS vs. Top-Down Mean EPS (Trailing 26-Weeks)

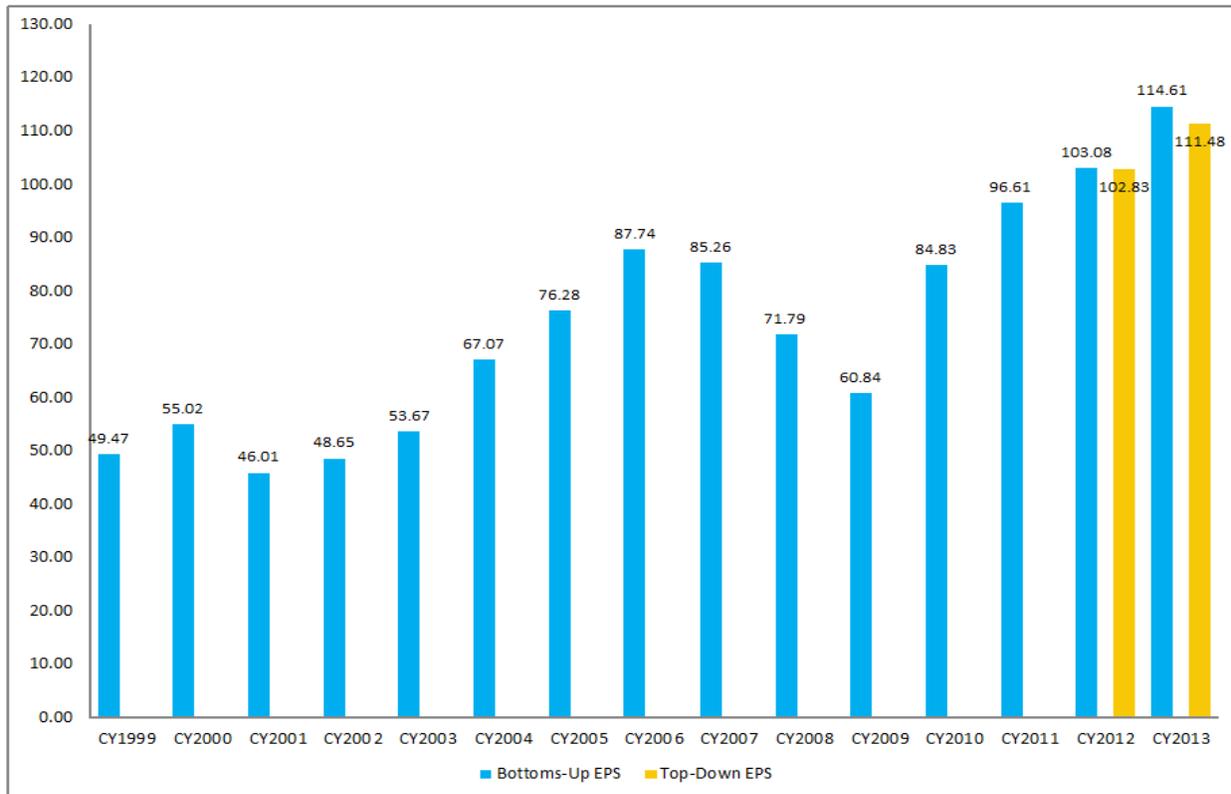


Change in Q312 and Q412 Bottom-Up EPS vs. Price (Trailing 26-Weeks)

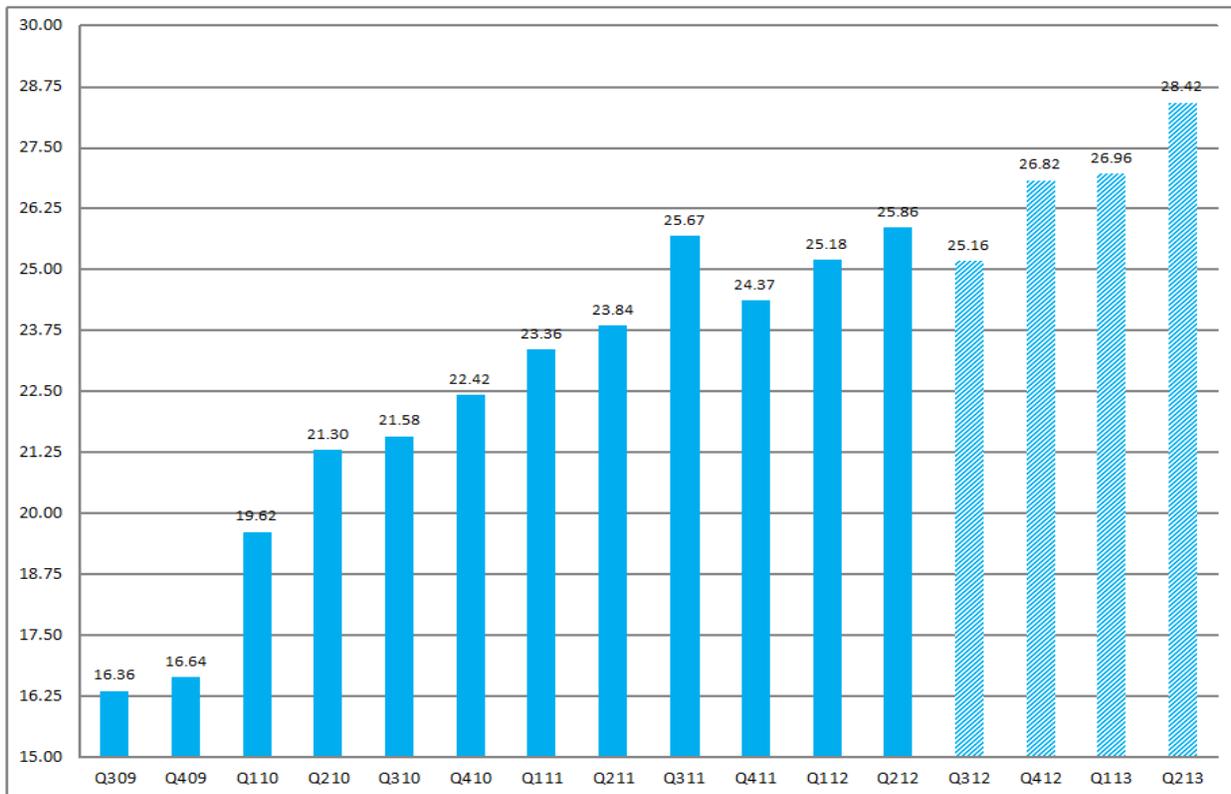


## Bottom-up Estimates: Current & Historical

Calendar Year Bottom-Up EPS Actuals & Estimates

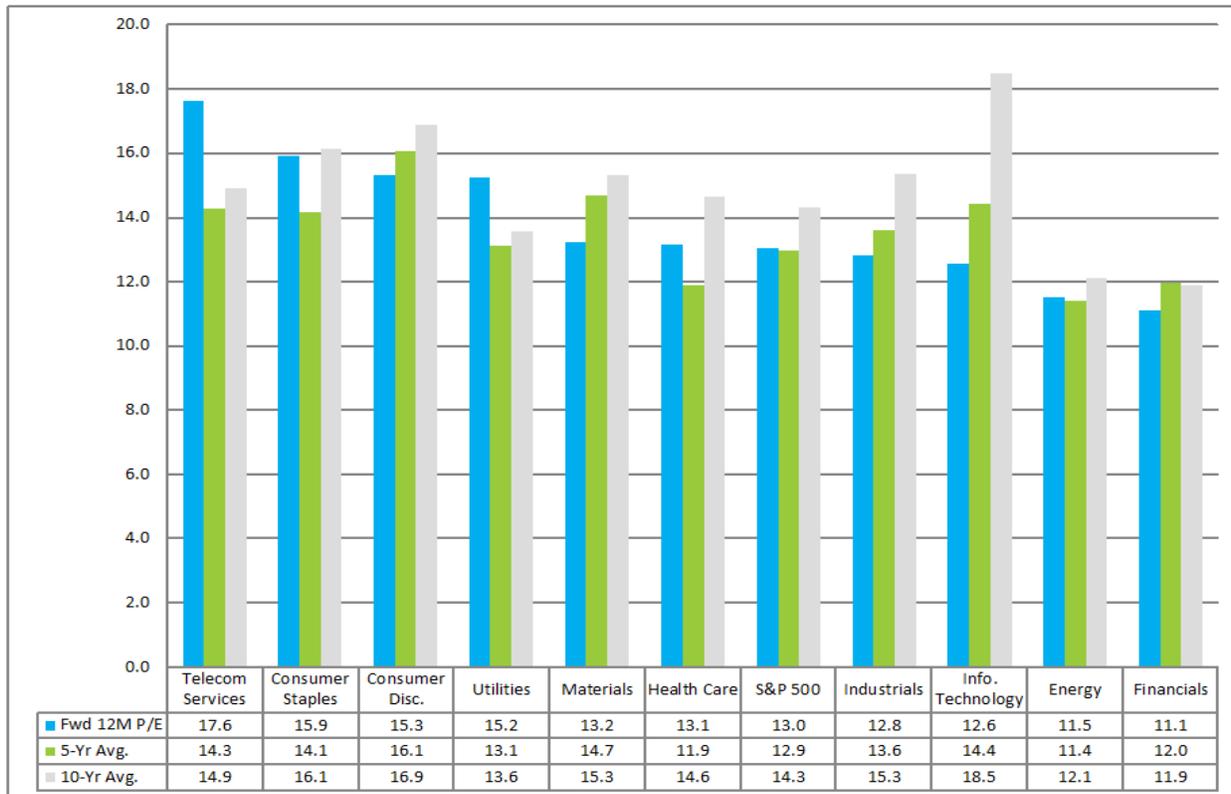


Calendar Year Bottom-Up EPS Actuals & Estimates

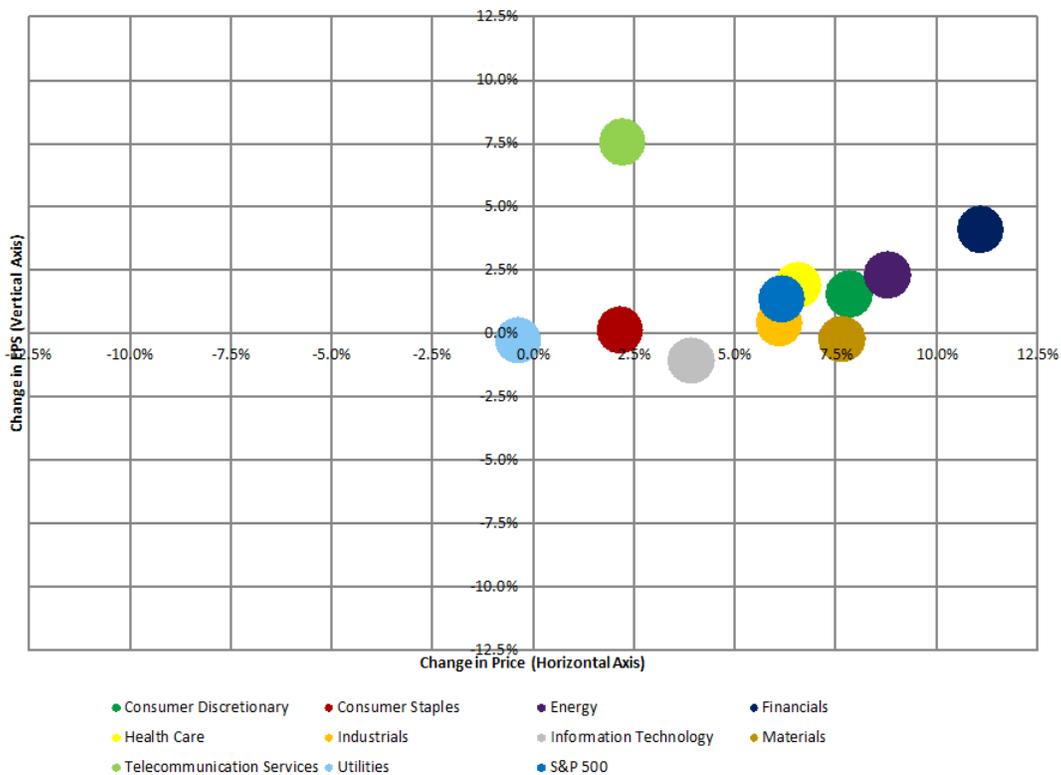


## Price / Earnings Ratio: Sector Level

Sector-Level Forward 12-Month P/E Ratios

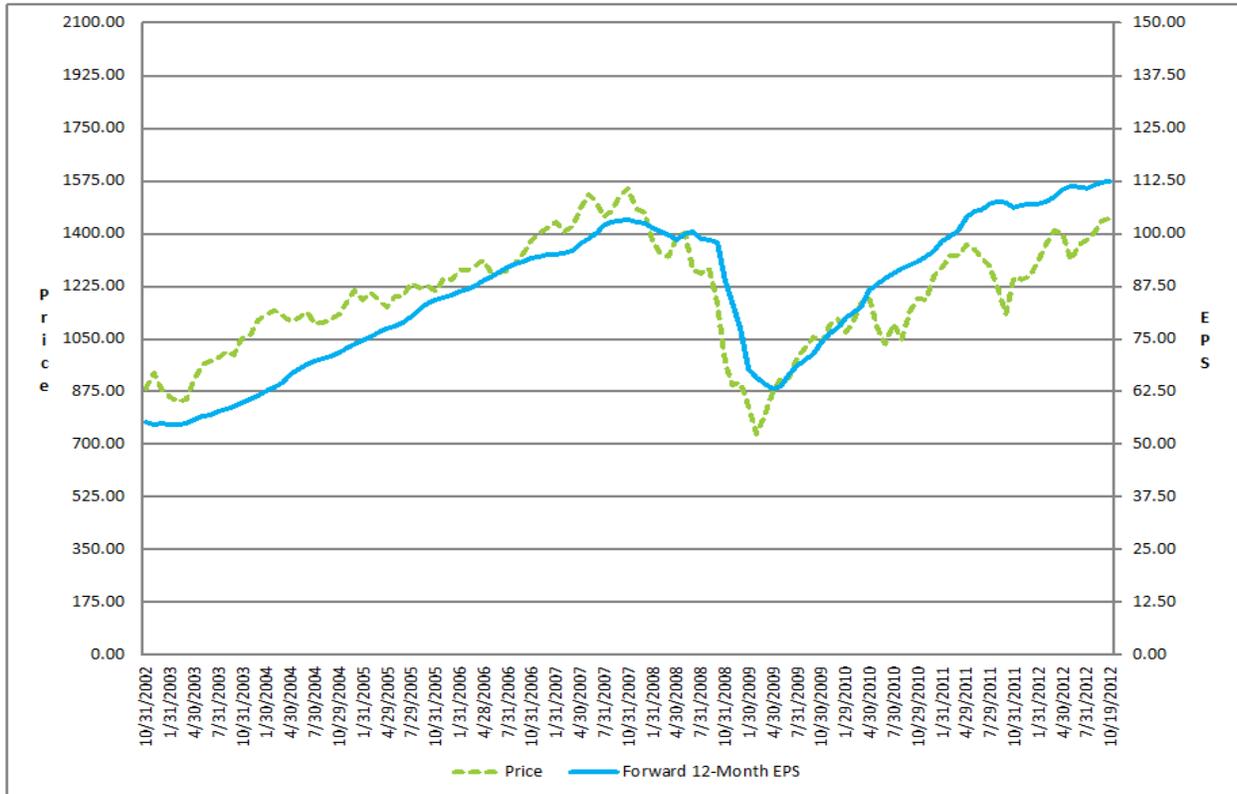


Sector-Level Change in Price vs. Change Forward 12M EPS: 3-Months

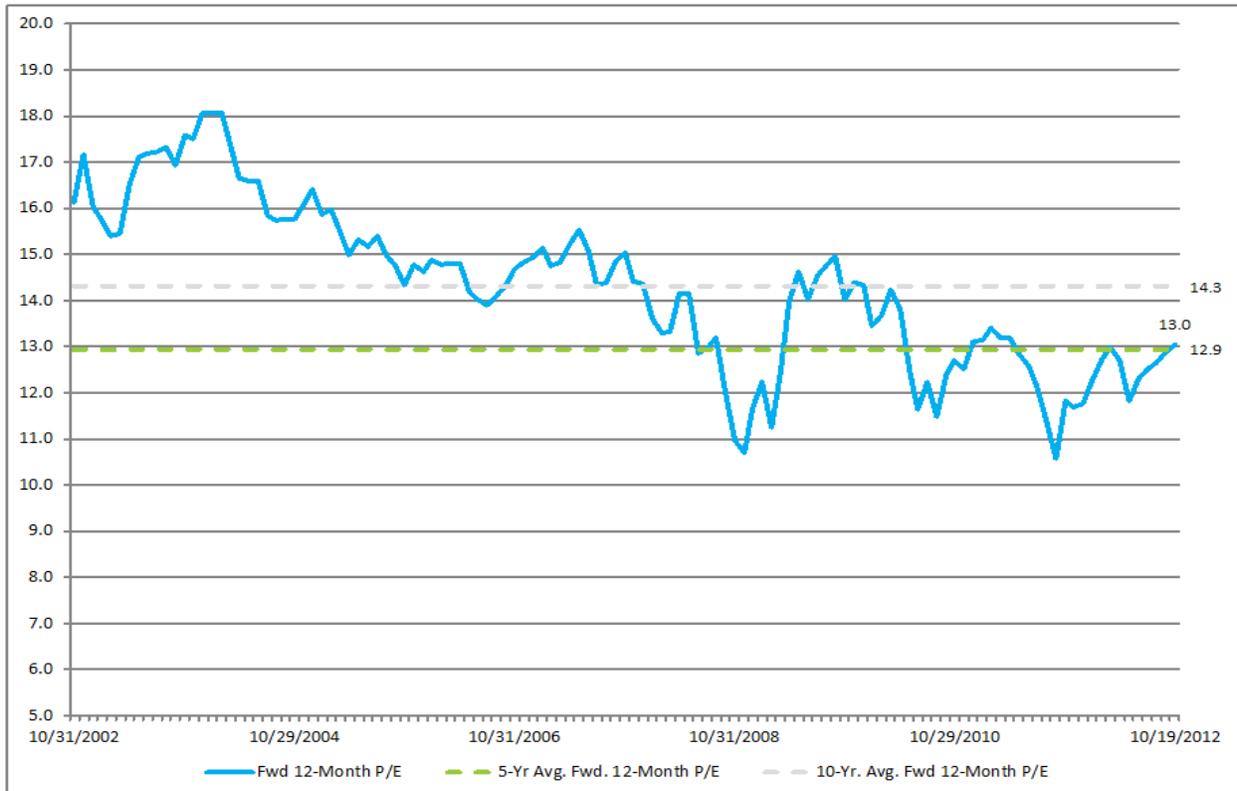


## Price / Earnings Ratio: Long-Term Averages

Change in Price vs. Change in Forward 12M EPS: 10-Year



Forward 12M P/E Ratio: 10-Years



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