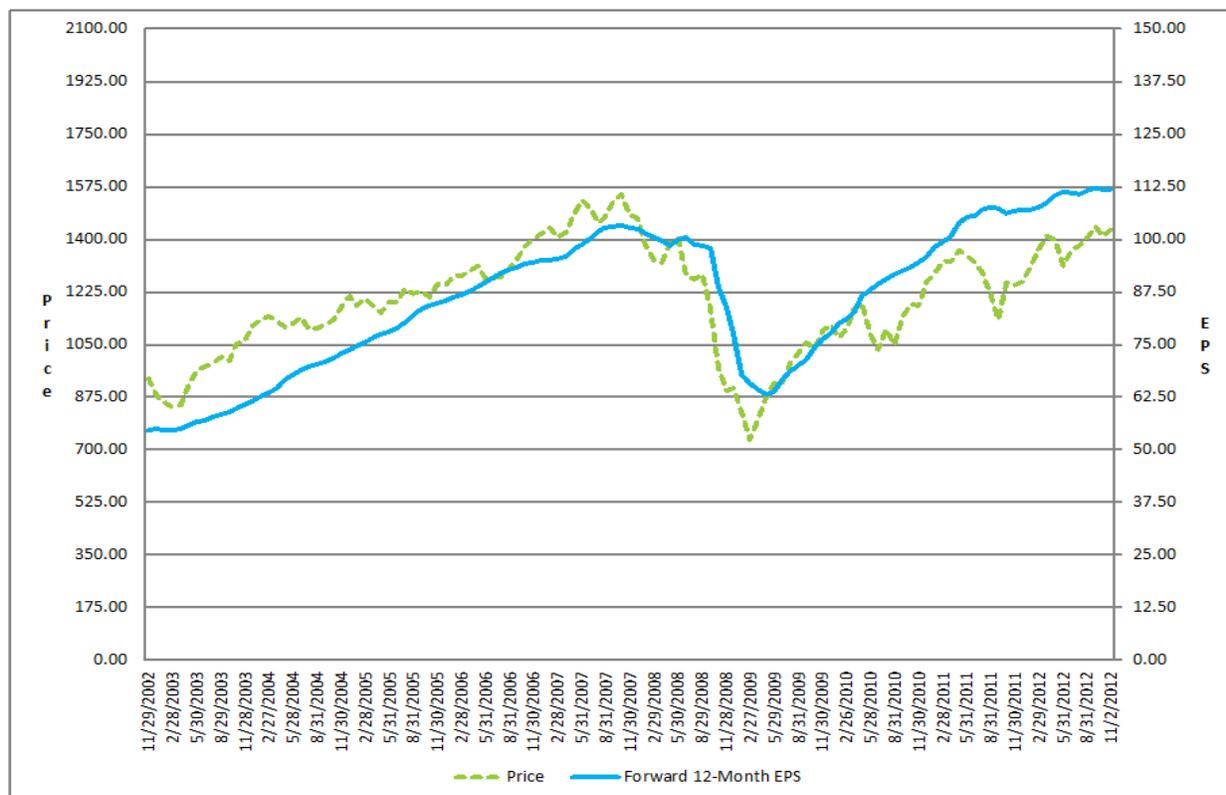


### Key Metrics

- + **Earnings Scorecard:** Of the 350 companies that have reported earnings to date for Q3 2012, 70% have reported earnings above the mean estimate, but only 40% have reported sales above the mean estimate.
- + **Earnings Growth:** The blended earnings growth rate for Q3 2012 is -0.5%. If -0.5% 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 -3.0%. The Financials and Energy sectors have been the largest contributors to the improvement in earnings growth for the index since the end of the quarter.
- + **Earnings Guidance:** For Q4 2012, 56 companies have issued negative EPS guidance and 18 companies have issued positive EPS guidance.
- + **Valuation:** The current 12-Month forward P/E ratio is 12.6. 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



## Topic of the Week:

### Downward Estimate Revisions for First Month of Q4 on Pace with Recent Averages

For the fourth quarter, 56 of the 74 companies (or 76%) that have issued EPS guidance have guided earnings below analyst expectations. If 76% is the final percentage for the quarter, it will mark the highest percentage of negative guidance for a quarter since FactSet began tracking guidance in 2006.

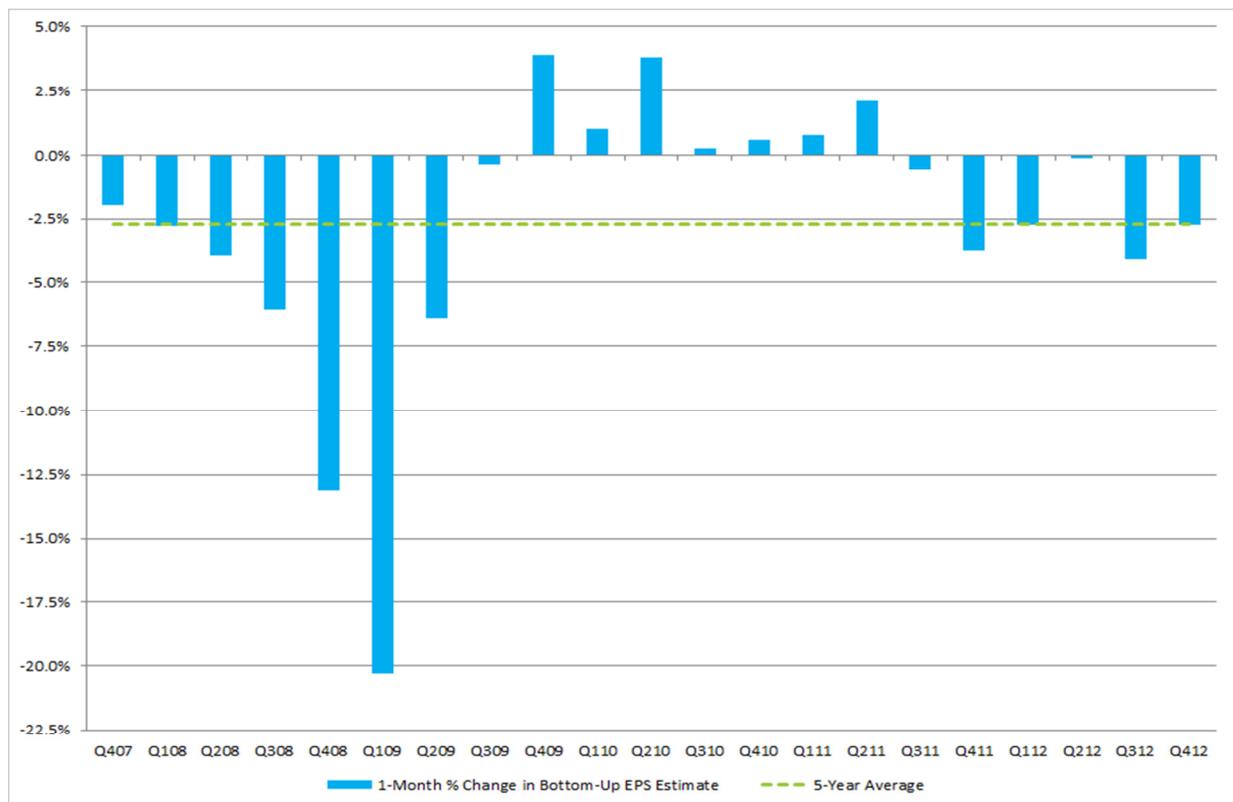
Given the high percentage of companies that have issued negative EPS guidance, did analysts cut estimates at an unusually high pace during the first month of the fourth quarter?

The answer is no. The bottom-up EPS estimate for Q4 dropped 2.7% during the month of October (to \$26.16 from \$26.89). Over the past four quarters, the average decline in the EPS estimate during the first month of the quarter has been -2.7%. Over the past five years, the average decrease in the EPS estimate over the first month of the quarter has been -2.7%.

One reason that the percentage of negative guidance is unusually high while the percentage of downward estimate revisions is average is the difference in the number of companies that issue guidance from sector to sector. The three sectors that saw the highest percentage cuts to sector-level EPS estimates for Q4 during October were the Materials, Information Technology, and Industrials sectors. These are three sectors in which large numbers of companies typically issue quarterly guidance. Of the 74 companies that issued EPS guidance for Q4, 38 (or 51.4%) of these companies were in these three sectors. Of these 38 preannouncements, 30 were negative.

On the other hand, the Utilities, Financials, and Energy sectors actually recorded slight increases to sector-level EPS estimates for Q4 during the month of October. However, these are three sectors in which only a small number of companies typically issue quarterly guidance. Of the 74 companies that issued EPS guidance for Q4, just 9 (or 12.2%) of these companies were in these three sectors. Of these 9 preannouncements, three were positive.

Change in S&P 500 Bottom-Up EPS Estimate in First Month of the Quarter: 5-Year



## Q3 2012 Earnings Season: Overview

### Large Number of Companies Miss Revenue Estimates, but Still Beat EPS Estimates

This past week marked the third 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 substantially below recent and historical averages.

### Large Upside Earnings Surprises Reported By Companies in the Telecom Services & Financials Sectors

Overall, 350 companies have reported earnings to date. Of these 350 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 Health Care (82%) and Consumer Staples (80%) sectors have the highest percentages of companies reporting earnings above estimates, while the Energy (48%) sector has the lowest percentage of companies reporting earnings above estimates.

In aggregate, companies are reporting earnings that are 4.8% above expectations. Over the last four quarters on average, actual earnings have surpassed estimates by 4.7%. Companies in the Telecom Services (17.0%) and Financials (10.7%) sectors are reporting the largest aggregate differences between actual earnings and estimated earnings. In the Telecom Services sector, MetroPCS Communications (49.9%) and Sprint Nextel (39.7%) reported substantial upside earnings surprises. In the Financials sector, companies such as Travelers (35.5%), Goldman Sachs (30.0%), JPMorgan Chase (15.5%), and Morgan Stanley (14.6%) have reported significant upside earnings surprises.

### Lowest Percentage (40%) of Companies Beating Sales Estimates since Q1 2009

In terms of revenues, 40% of companies have reported actual sales above estimated sales and 59% have reported actual sales below estimated sales. If 40% is the final number, it will mark the lowest percentage of companies reporting sales above estimates for a quarter since Q1 2009 (36%).

At the sector level, the Industrials (23%), Utilities (23%) and Materials (24%) sectors have the lowest percentages of companies reporting sales above estimates, while the Financials (58%) and Energy (52%) sectors have the highest percentage of companies reporting sales above estimates.

In aggregate, companies are reporting sales that are 0.3% above expectations. Over the previous four quarters on average, actual sales have exceeded estimates by 0.4%.

### Upside EPS Surprises in Energy Sector Drive Improvement in Earnings Growth This Week

The blended earnings growth rate for the third quarter is -0.5% this week, above last week's growth rate of -1.3%. Upside earnings surprises from companies in the Energy sector were mainly responsible for the increase in the blended earnings growth rate during the week.

In the Energy sector, Exxon Mobil (+6.9%) and Phillips 66 (+29.7%) reported substantial upside earnings surprises that were large contributors to the increase in earnings growth for the index for the week. The blended earnings growth for the Energy sector improved to -16.5% from -19.3% during this time.

Since the end of the third quarter (September 30), the earnings growth rate for the index has improved to -0.5% from -3.0%. Seven of the ten sectors have seen an increase in their earnings growth rates over this time frame. However, the Financials and Energy sectors are the largest contributors to the increase in earnings growth for the index since the end of the quarter, due to upward revisions to estimates and upside earnings surprises reported by a number of companies in each of these sectors.

## Earnings Decline (-0.5%) for Q3 Led By Commodity Sectors: Materials and Energy

The blended earnings growth rate for Q3 2012 is -0.5%. 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, five of the ten sectors are reporting a year-over-year decline in earnings for the quarter. Of these five sectors, the Materials and Energy sectors have the lowest earnings growth rates. On the other hand, the Financials sector has the highest earnings growth rate of all ten sectors.

### Energy & Materials Sectors: Earnings Decreases Due to Year-Over-Year Price Declines

The Materials sector has the lowest earnings growth rate (-23.4%) and the second lowest revenue growth rate (-6.2%) of all ten sectors. Ten of the twelve sub-industries in this sector are reporting a year-over-year decrease in earnings. Seven of these ten sub-industries are reporting double-digit declines in earnings, led by the Aluminum (-80%), Steel (-60%), and Diversified Metals & Mining (-37%) sub-industries.

The Energy sector has the second lowest earnings growth rate (-16.5%) and the lowest sales growth rate (-15.7%) of all ten sectors. Five of the seven sub-industries in the sector are reporting a decline in earnings, led by the Coal & Consumable Fuels (-94%) and Oil & Gas Exploration & Production (-33%) 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 2.5%.

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)*

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

The Financials sector has the highest earnings growth rate (15.6%) 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 -3.4%. Earnings growth is broad-based across the sector. Fifteen of the 19 sub-industries are reporting earnings growth. Eleven of the these fifteen sub-industries are reporting double-digit earnings growth, led by Regional Banks (52%), Insurance Brokers (44%), Residential REITs (41%), Property & Casualty Insurance (35%), Specialized REITs (32%), 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 0.7%, which is the third lowest sales growth rate in the index.

## Revenue Decline (-0.9%)

In terms of revenues, the blended growth rate stands at -0.9%, down from an estimate of 0.0% at the end of the quarter (September 30). The decrease in revenue growth since the start of the quarter is due to the high number of companies reporting sales below estimates. 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 (-15.7%) and Materials (-6.2%) 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 2.1%.

## Multi-National Companies Feel Impact of Global Slowdown: Europe, F/X Rates, & China

Companies in the index are reporting lower revenue growth outside of the U.S. for Q3 2012 relative to recent years due to weak economic growth in Europe, less favorable foreign exchange rates, and slower economic growth in emerging markets (China).

### 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.

*“Service orders of \$2 billion were down 1%, also driven by Europe, down 12%...” – GE (Oct. 19)*

*“On a year-over-year basis, total commercial HVAC revenues decreased by 2 percent (flat excluding currency) primarily due to declining markets in Western Europe and currency translation.” – Ingersoll-Rand (Oct. 19)*

*“From a geographic perspective, this quarter we saw tough conditions in Europe where revenue declined mid-single digits.” –Microsoft (Oct. 18)*

### 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.

*“Sales in the quarter were \$7.5 billion, basically flat when compared with last year. Currency was again a factor, a drag of 3.1%.” –3M (Oct. 23)*

*“Lastly, I'd like to touch on foreign currency translation, which negatively impacted third quarter results by \$0.08.” –McDonald's (Oct. 19)*

*“Now as Dave mentioned earlier, sales were up slightly year over year. We had 2% organic growth. Acquisitions contributed 1% growth, while currency yielded a 3% headwind in the quarter. Of course, that has been a challenge this year as FX.” –Honeywell (Oct. 19)*

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

*“International sales increased 1.4%, reflecting operational growth of 8.9% and a negative currency impact of 7.5%.” –Johnson & Johnson (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.

*“Sales in China remained weak in the third quarter and below the third quarter of 2011...While we have reduced production in China substantially, we have not seen an improvement in sales yet, and, as a result, the inventory reduction in China is slower than we had expected.” -Caterpillar (Oct. 22)*

*“...while organic revenues in the emerging markets increased 10%, slightly below expectations primarily due to slowing markets in China.” –Stanley Black & Decker (Oct. 17)*

*“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)*

### **Cost-Cutting Announcements**

A number of companies that reported substantial year-over-year declines in revenues have also announced either restructuring or cost-cutting measures in their earnings releases or conference calls for the quarter.

*“The company has commenced a restructuring plan to increase productivity, enhance competitiveness and accelerate growth. The plan will deliver pre-tax cost savings of about \$450 million (\$300 million in 2013) by eliminating corporate costs supporting Performance Coatings and taking additional cost-cutting actions to improve competitiveness. The restructuring plan includes eliminating about 1,500 positions globally in the next 12-18 months.” –DuPont (Oct. 23)*

*“The Dow Chemical Company today announced a restructuring program designed to accelerate cost reduction actions and advance the next stage of the Company’s transformation in the midst of persistently slow macroeconomic growth. These actions will result in a net reduction of approximately 2,400 positions, or five percent of the global workforce. The restructuring also includes the shutdown of approximately 20 manufacturing facilities. Once fully implemented, these actions are expected to result in approximately \$500 million of annual operating cost savings by the end of 2014.” – Dow Chemical (Oct. 23)*

*“AMD expects that the restructuring actions taken in the fourth quarter of 2012 will result in operational savings, primarily in operating expenses, of approximately \$20 million in the fourth quarter of 2012 and approximately \$190 million in 2013. The savings will be largely driven through a reduction of AMD’s global workforce by approximately 15 percent, which is expected to be largely completed in the fourth quarter of 2012.” –AMD (Oct. 18)*

### **Q4 EPS Guidance: High Negative Percentage (76%)**

Of the 74 companies that have issued EPS guidance for the fourth quarter, 56 have issued projections below the mean EPS estimate and 18 have issued projections above the mean EPS estimate. Thus, 76% of the companies that have issued EPS guidance to date for Q4 2012 have issued negative guidance. This percentage is well above the long-term average (61%), but consistent with the percentage recorded in the previous quarter at this same point in time (78%).

### **Analysts Cutting Estimates for Q4 & 1<sup>st</sup> Half of 2013**

Since the end of the third quarter (September 30), analysts have reduced earnings growth expectations for Q4 2012 (to 6.4% from 9.5%), Q1 2013 (to 3.7% from 5.4%), and Q2 2013 (to 8.2% from 9.4%).

For Q4 2012, six of the ten sectors have seen a decrease in projected earnings growth, led by the Materials, Industrials, and Information Technology sectors.

Despite the reductions to earnings estimates for Q4 2012, analysts are still calling for an increase in earnings growth (6.4%) relative to Q3 2012 (-0.5%). Eight of the ten sectors are projected to report earnings growth, led by the Financials (29.7%) and Telecom Services (14.9%) sectors.

In addition, analysts are calling for slightly higher revenue growth rates in Q4 2012 (2.6%), Q1 2013 (1.2%) and Q2 2013 (3.6%) relative to the current growth rate for Q3 2012 (-0.9%)

**Valuation: Forward P/E at 12.6, Below 10-Year Average**

The current forward 12-month P/E ratio for the index is 12.6. The P/E ratio is based on Wednesday's closing price of 1412.16 and forward 12-month EPS estimate of 111.78.

This 12.6 P/E ratio is below the prior ten-year average forward 12-month P/E ratio of 14.3, and below the P/E ratio of 12.9 recorded at the start of the fourth quarter (September 30). The decrease in the P/E ratio since September 30 is due to the 2.0% drop in the price of the index since the start of the quarter (to 1412.16 from 1440.67). The forward 12-month EPS estimate has only declined slightly (to \$111.78 from \$112.00) over this time frame.

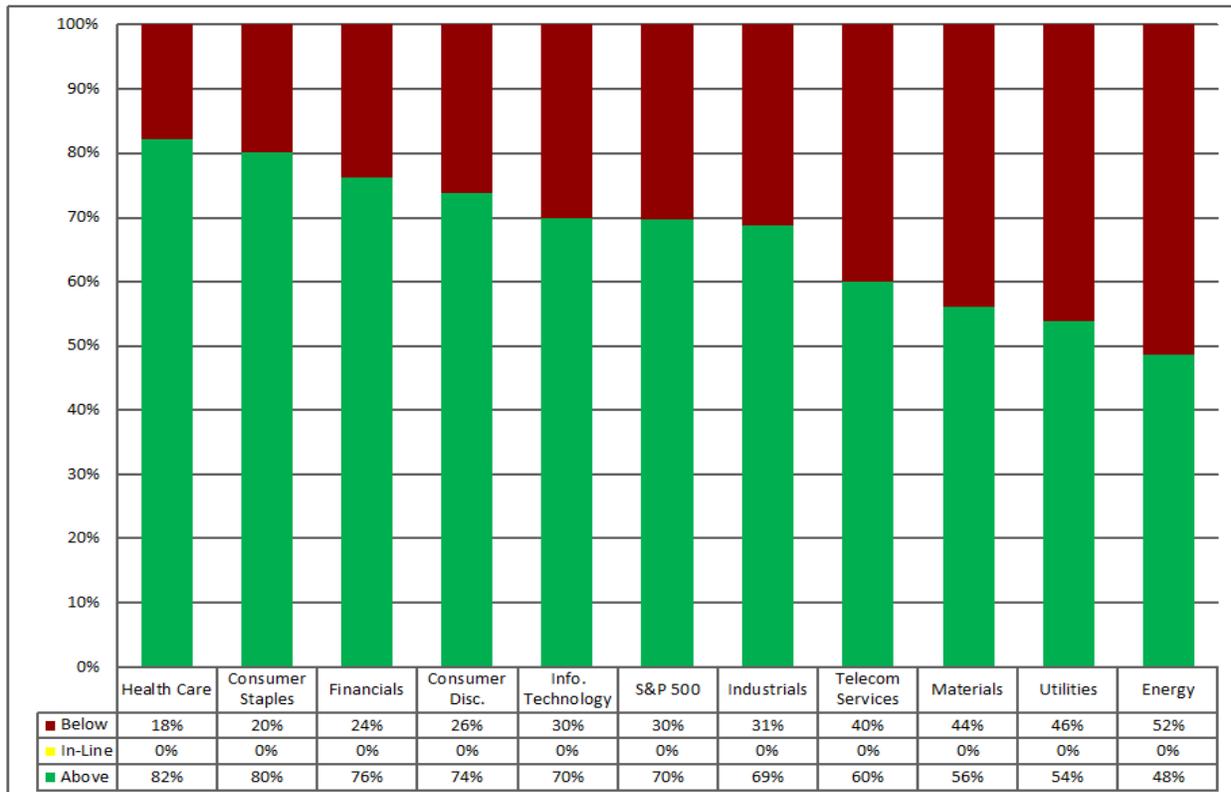
Will there be a return to the 10-year average valuation for the market anytime soon? If there is going to be a return to this average P/E ratio of 14.3, either future estimates will need to decrease, the price of the index will need to increase, or a combination of the two will need to occur.

**Companies Reporting Next Week: 66**

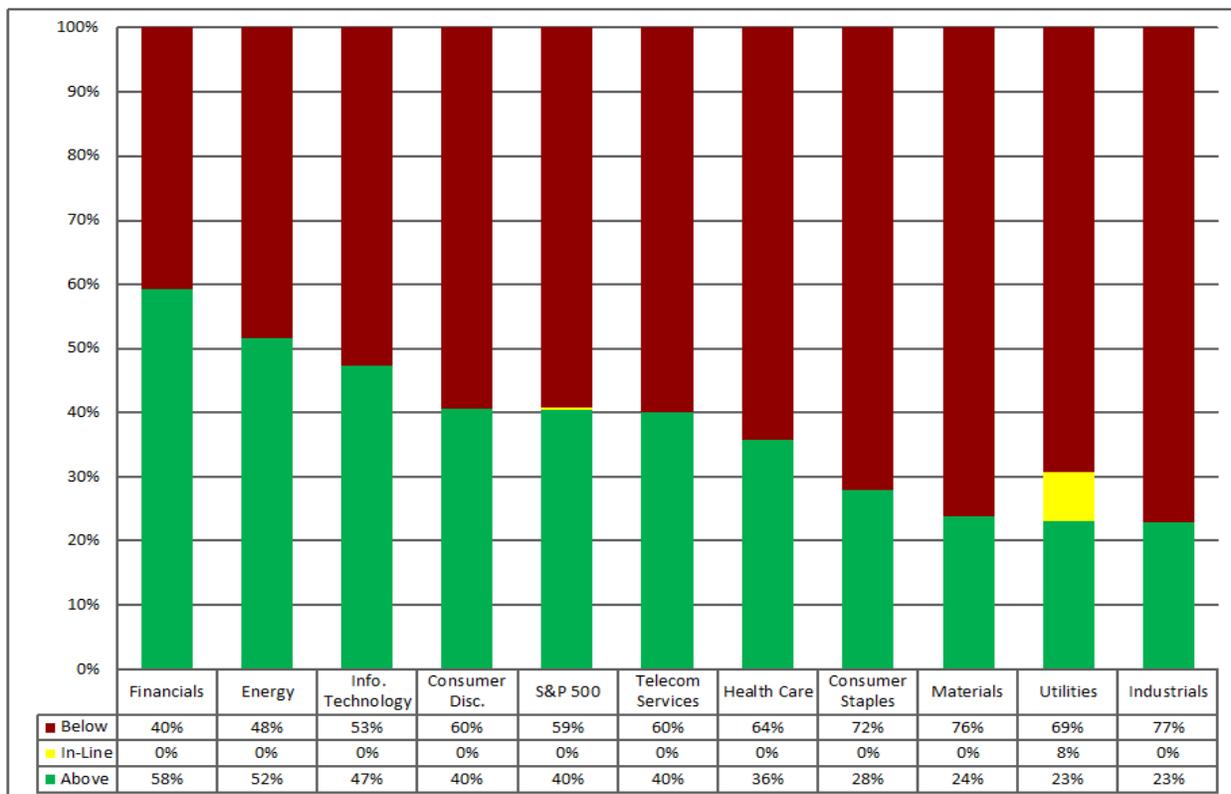
The upcoming week marks the final peak week of the Q3 2012 earnings season, as one Dow 30 component (Walt Disney) and 66 S&P 500 companies are scheduled to report earnings during the week.

Q3 2012: Scorecard

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

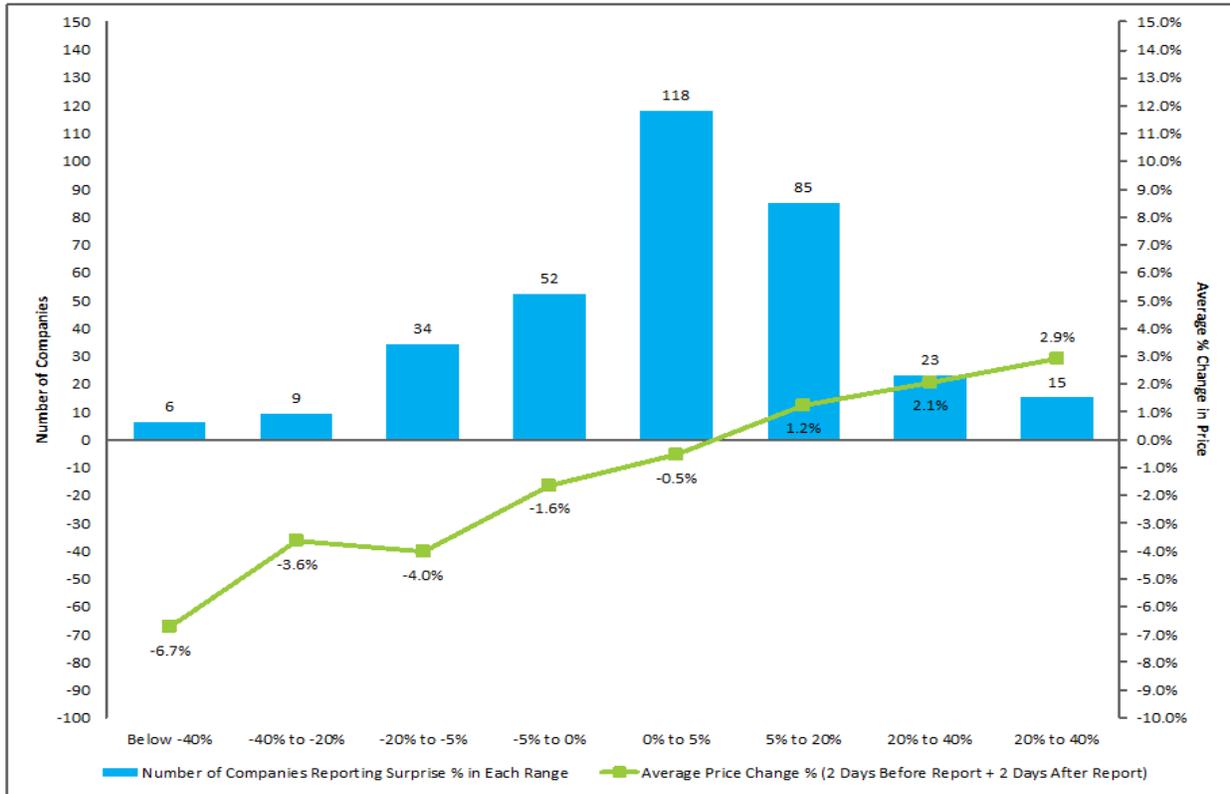


Q3 2012 Revenues: Above, In-Line, Below Estimates

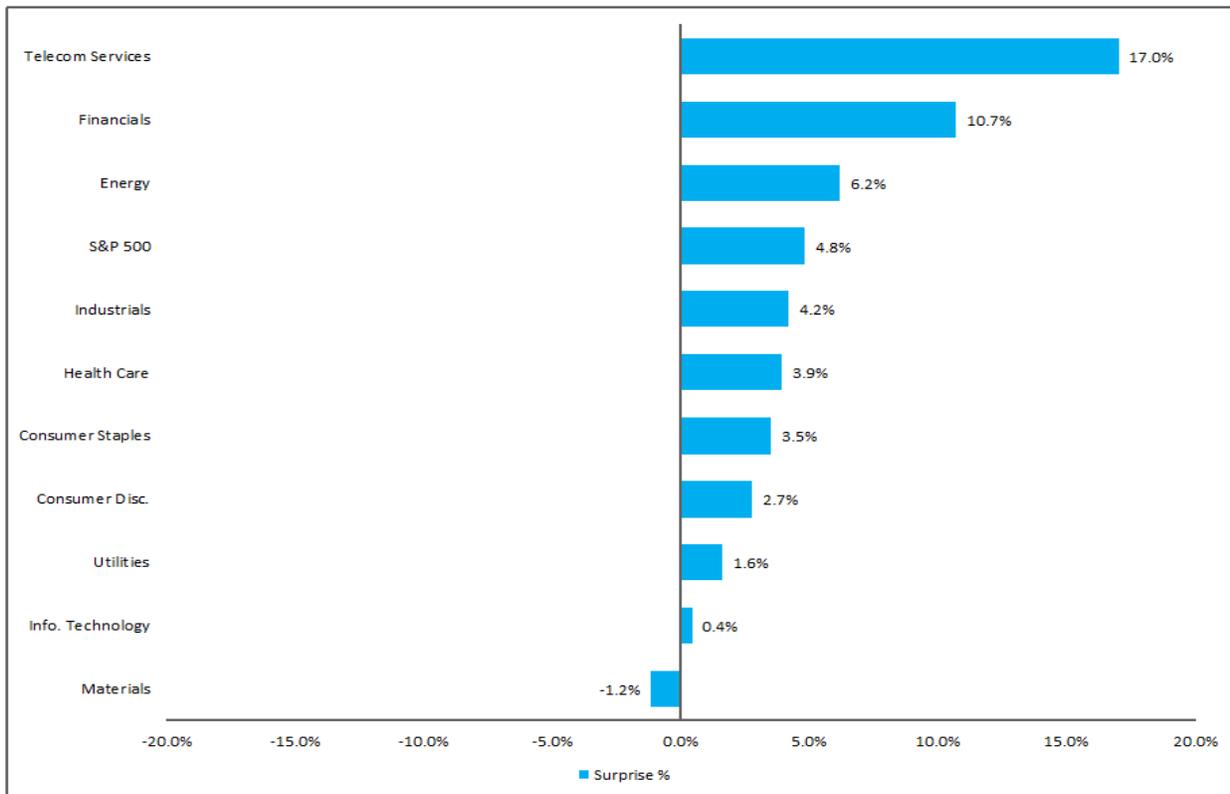


Q3 2012: Scorecard

Q3 2012: Surprise % vs. Average Price Change %

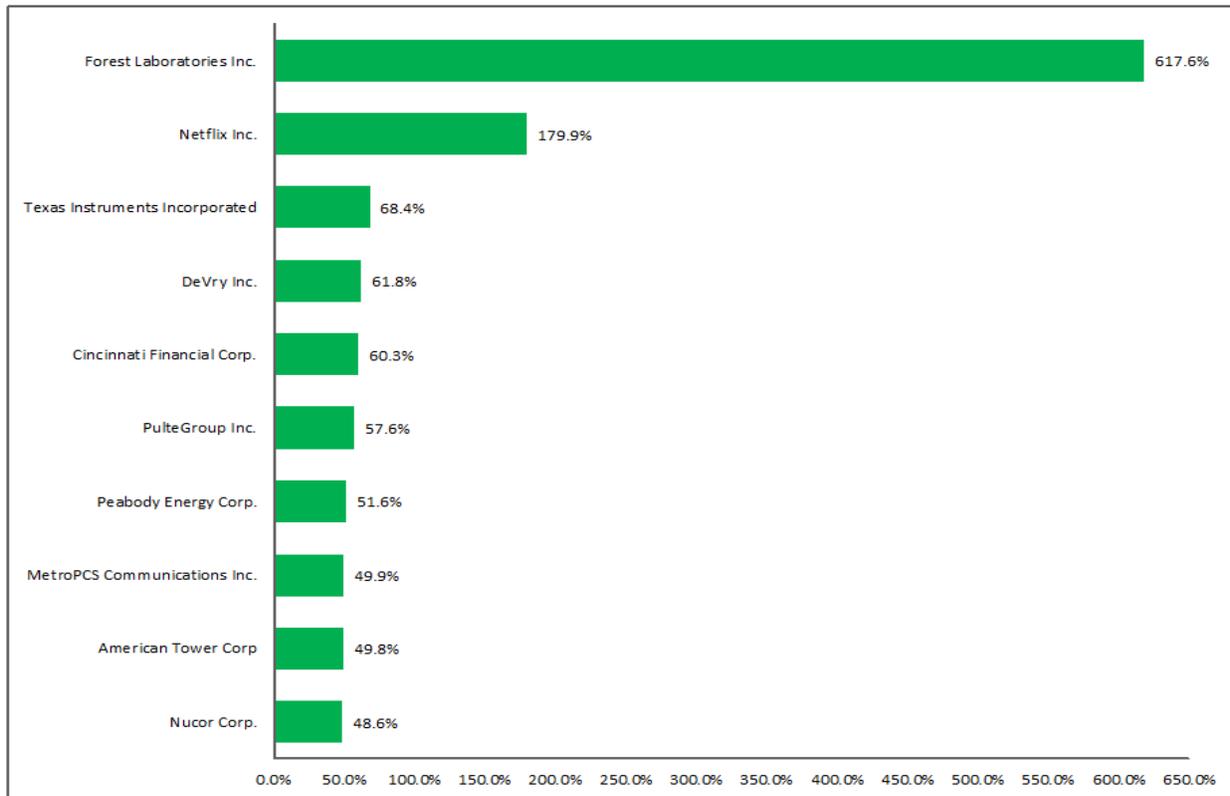


Q3 2012: Sector Level Surprise %

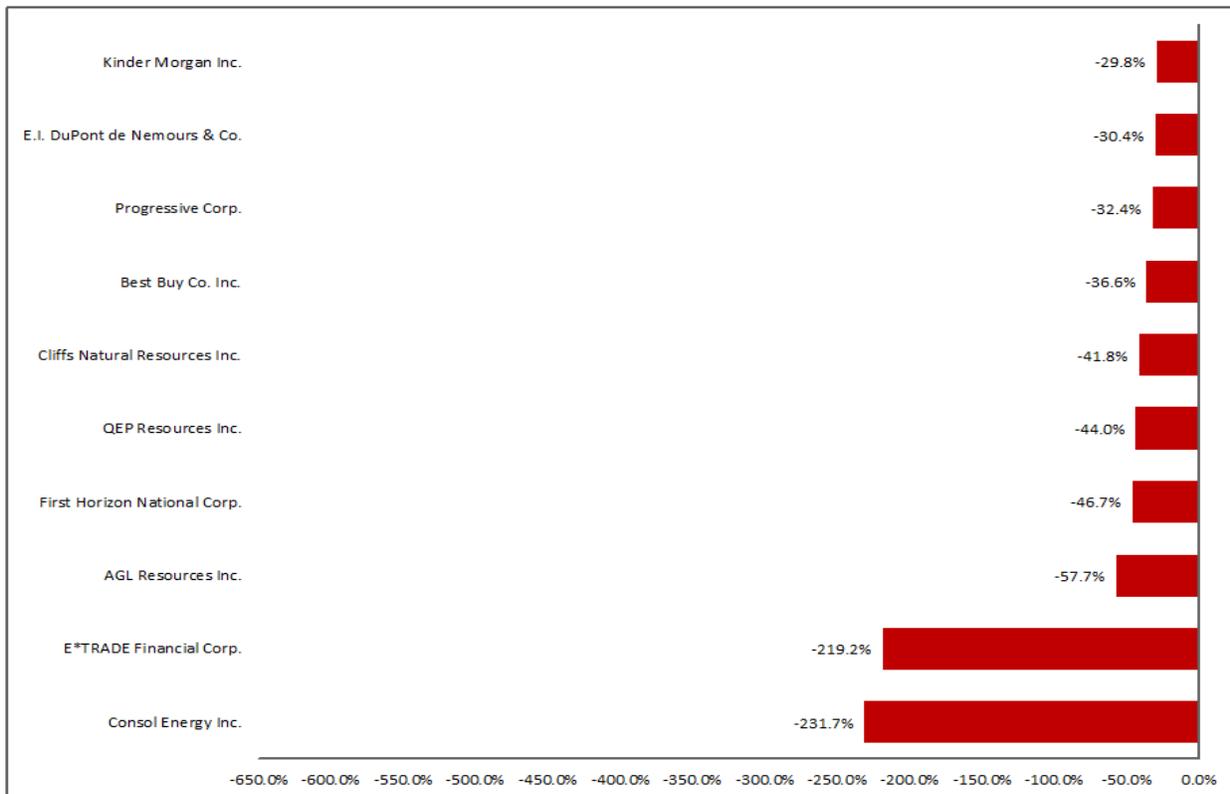


Q3 2012: Scorecard

Surprise %: Top 10 Companies

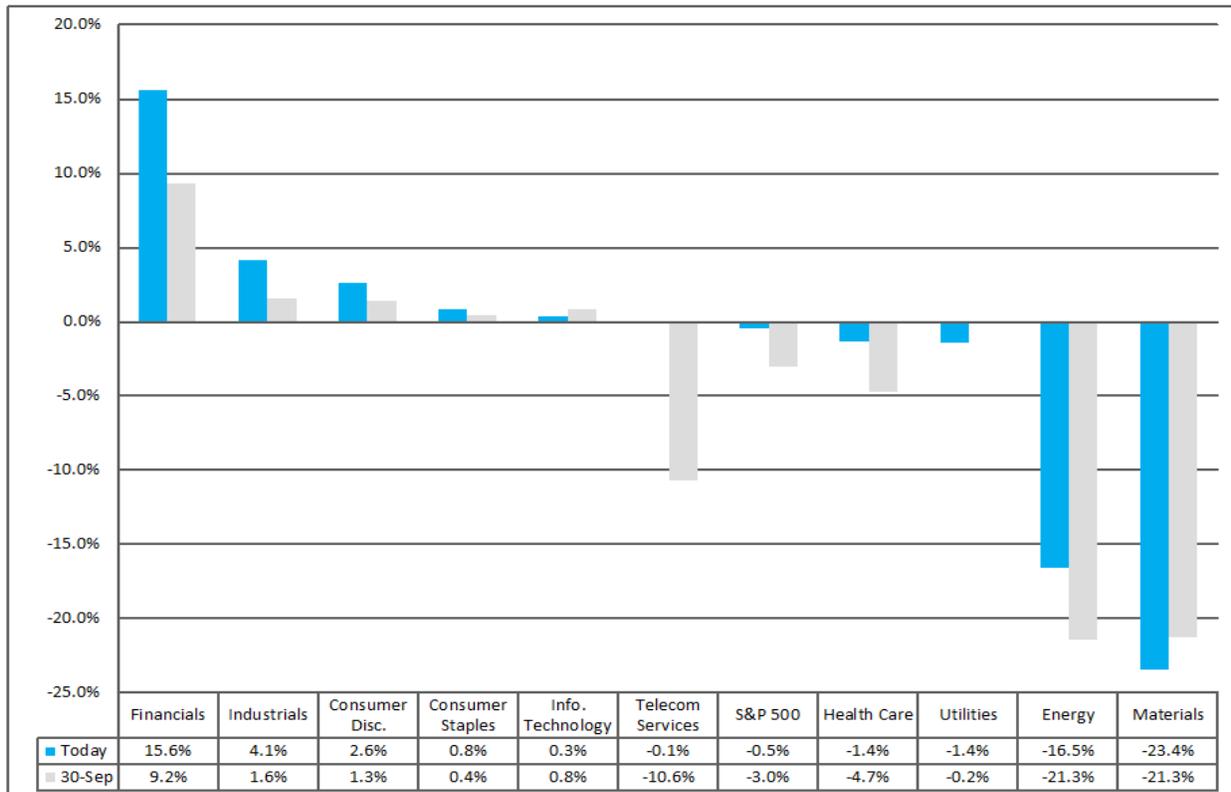


Surprise %: Bottom 10 Companies



Q3 2012: Growth

Q3 2012 Earnings Growth

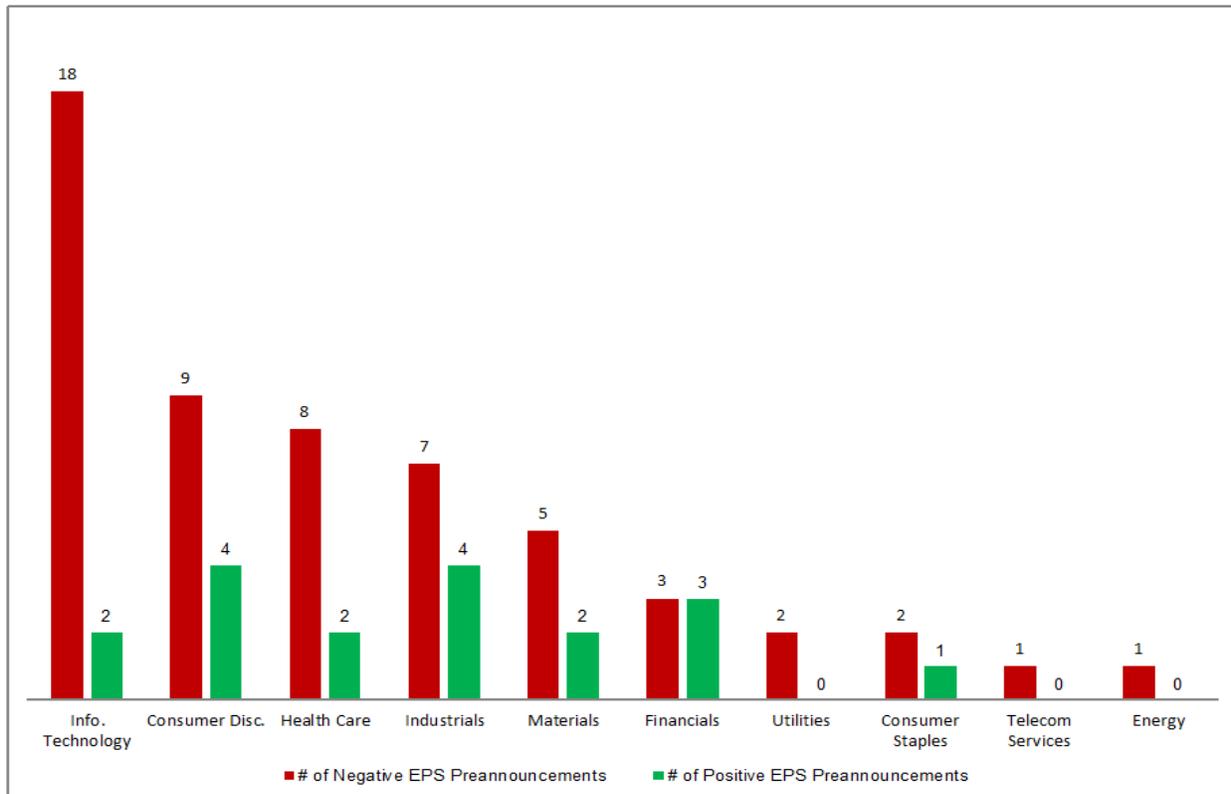


Q3 2012 Revenue Growth



Q4 2012: Guidance

Number of Positive & Negative EPS Preannouncements: Q4 2012

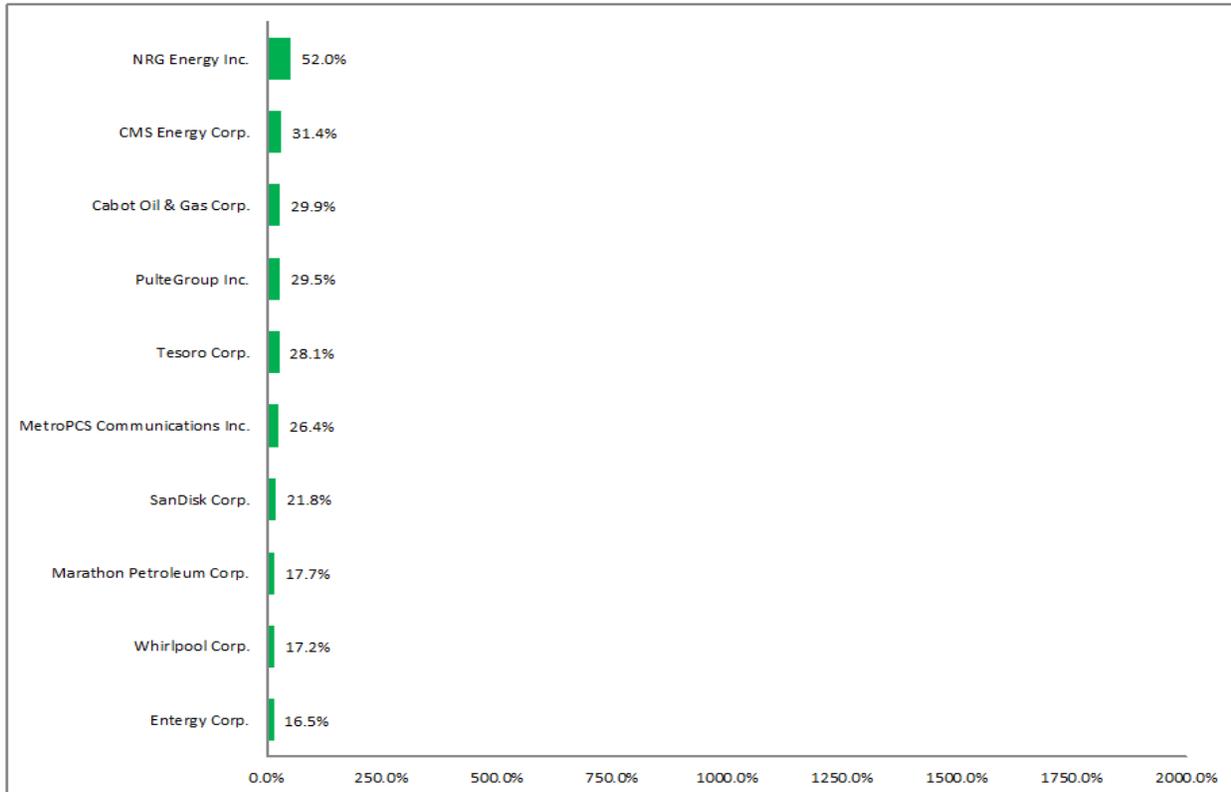


Percentage of Positive & Negative EPS Preannouncements: Q4 2012

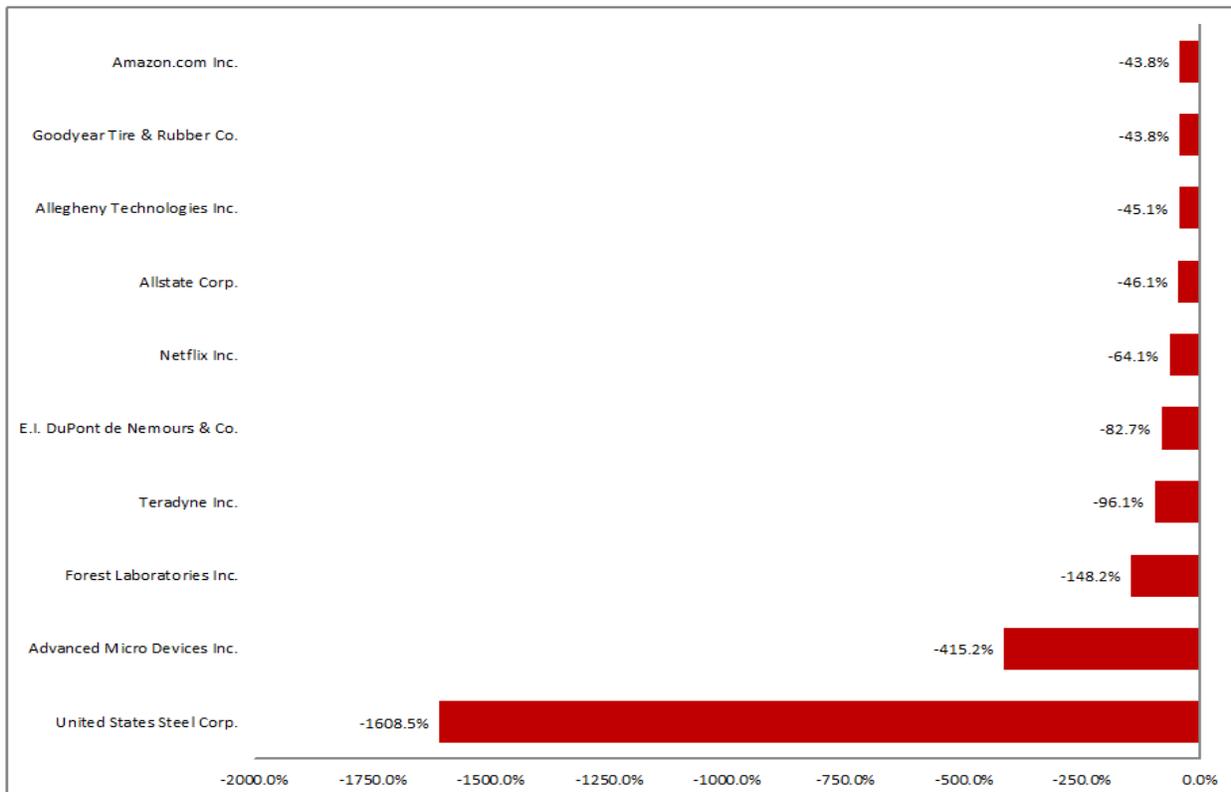


## Q4 2012: EPS Revisions

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

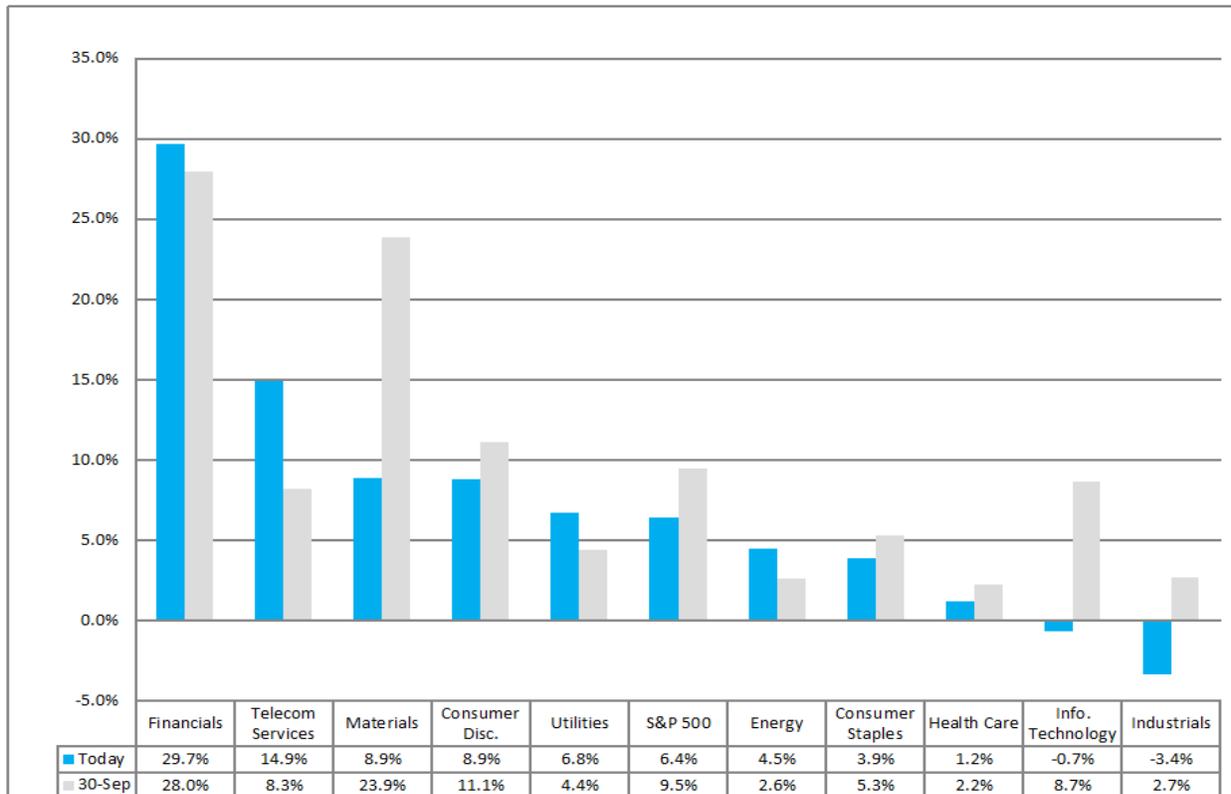


Highest Downward Change (Trailing 4-Weeks) in Mean EPS Estimate: Top 10 Companies

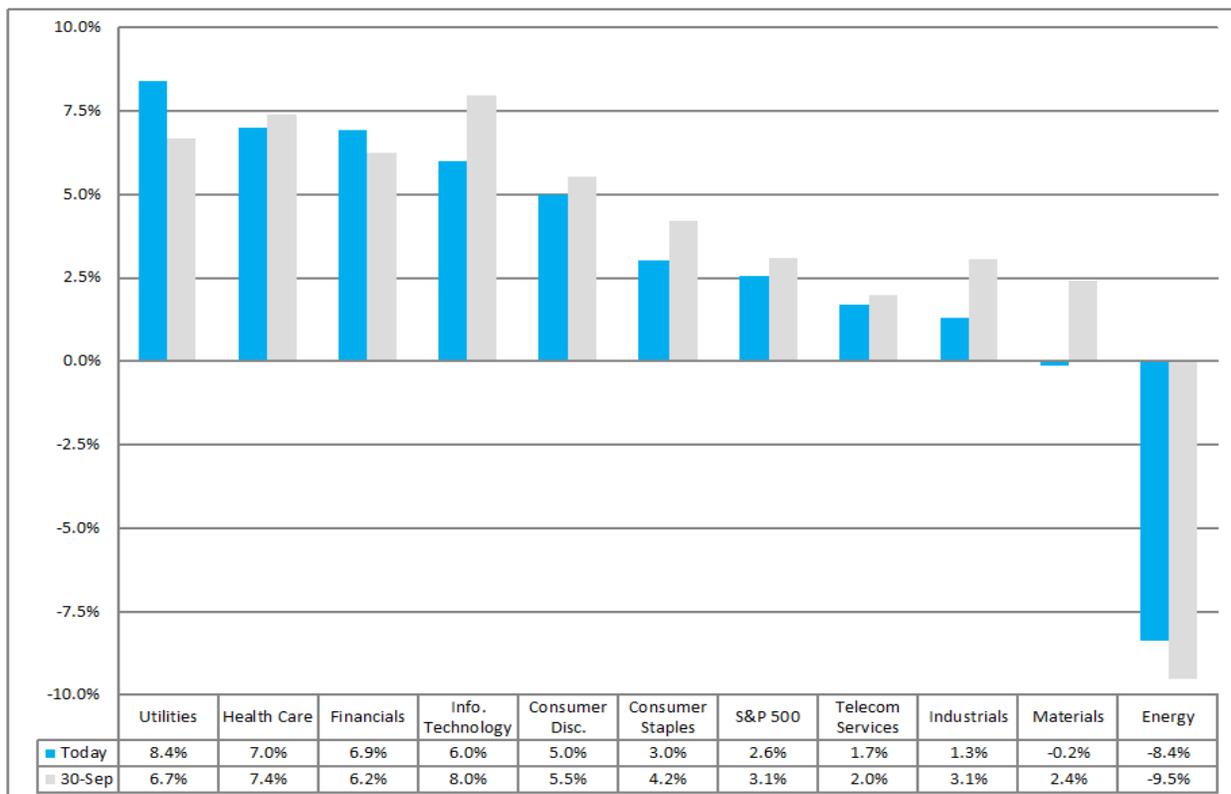


Q4 2012: Growth

Q4 2012 Earnings Growth



Q4 2012 Revenue Growth

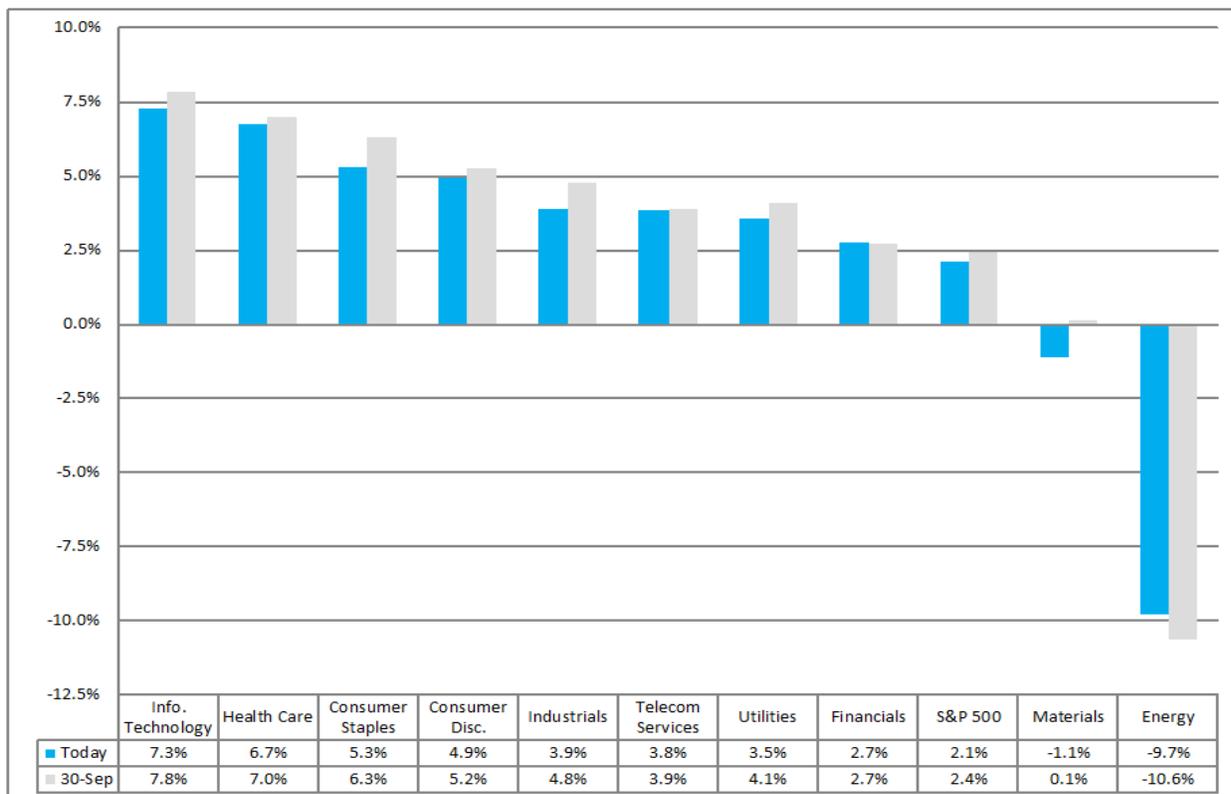


CY 2012: Growth

CY 2012 Earnings Growth

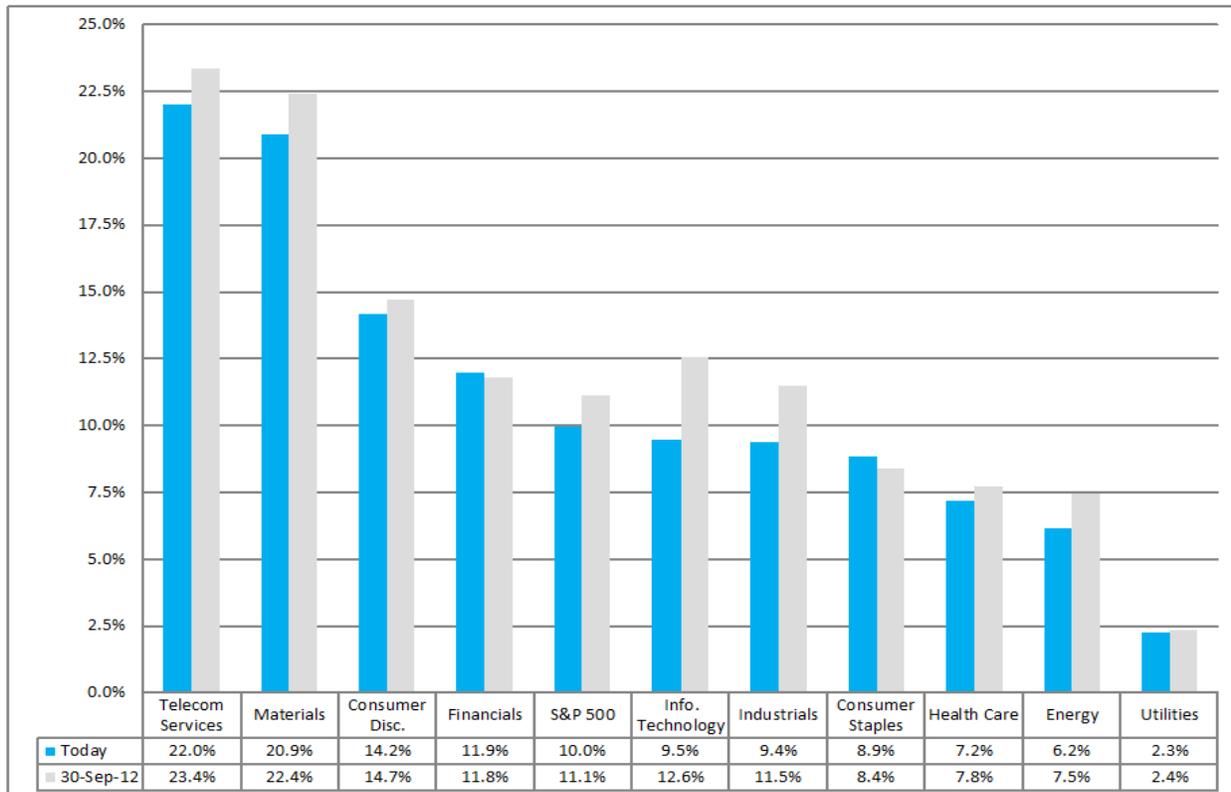


CY 2012 Revenue Growth

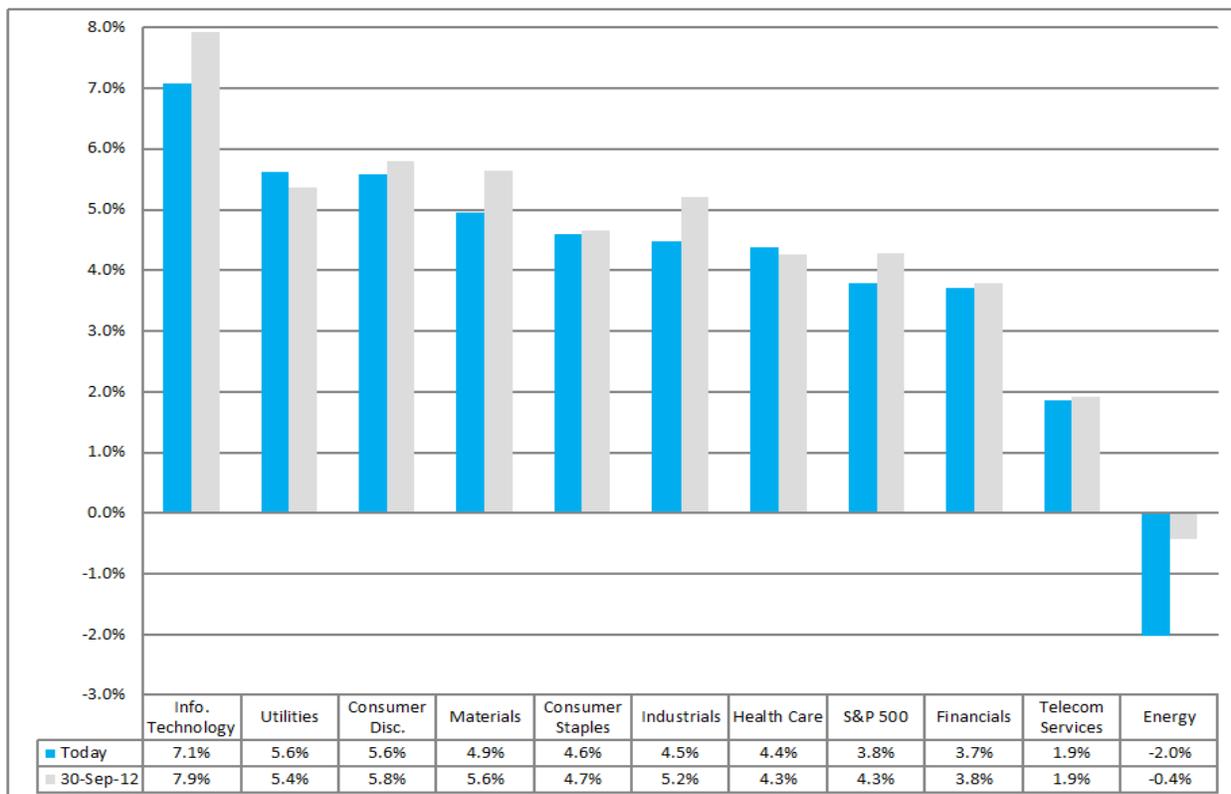


CY 2013: Growth

CY 2013 Earnings Growth

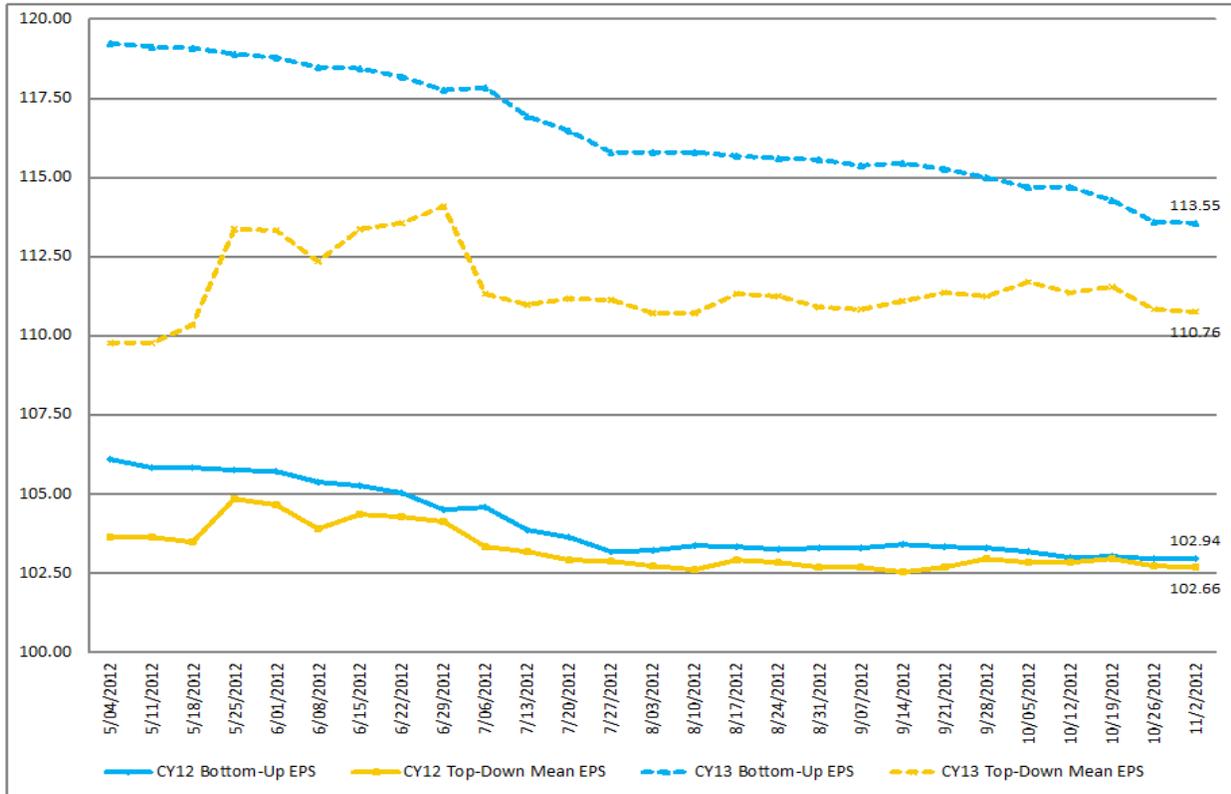


CY 2013 Revenue Growth

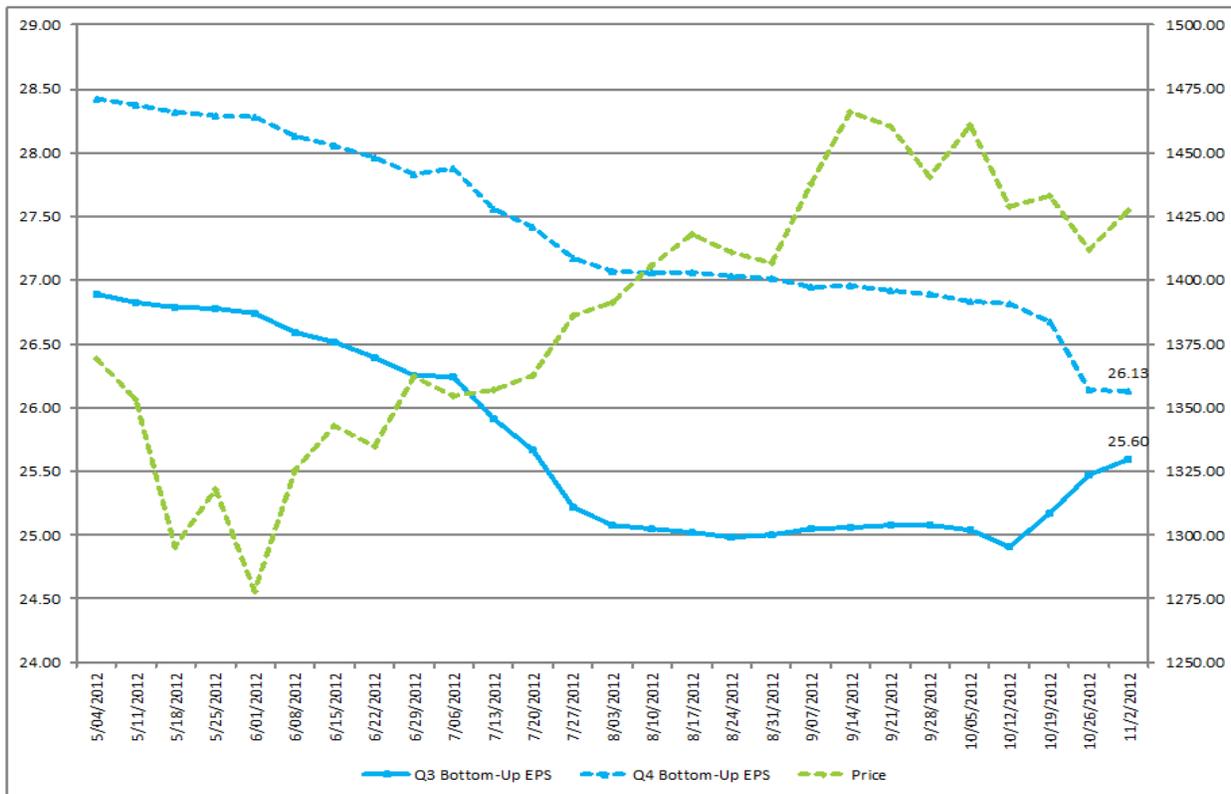


### Bottom-up Estimates: Revisions

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

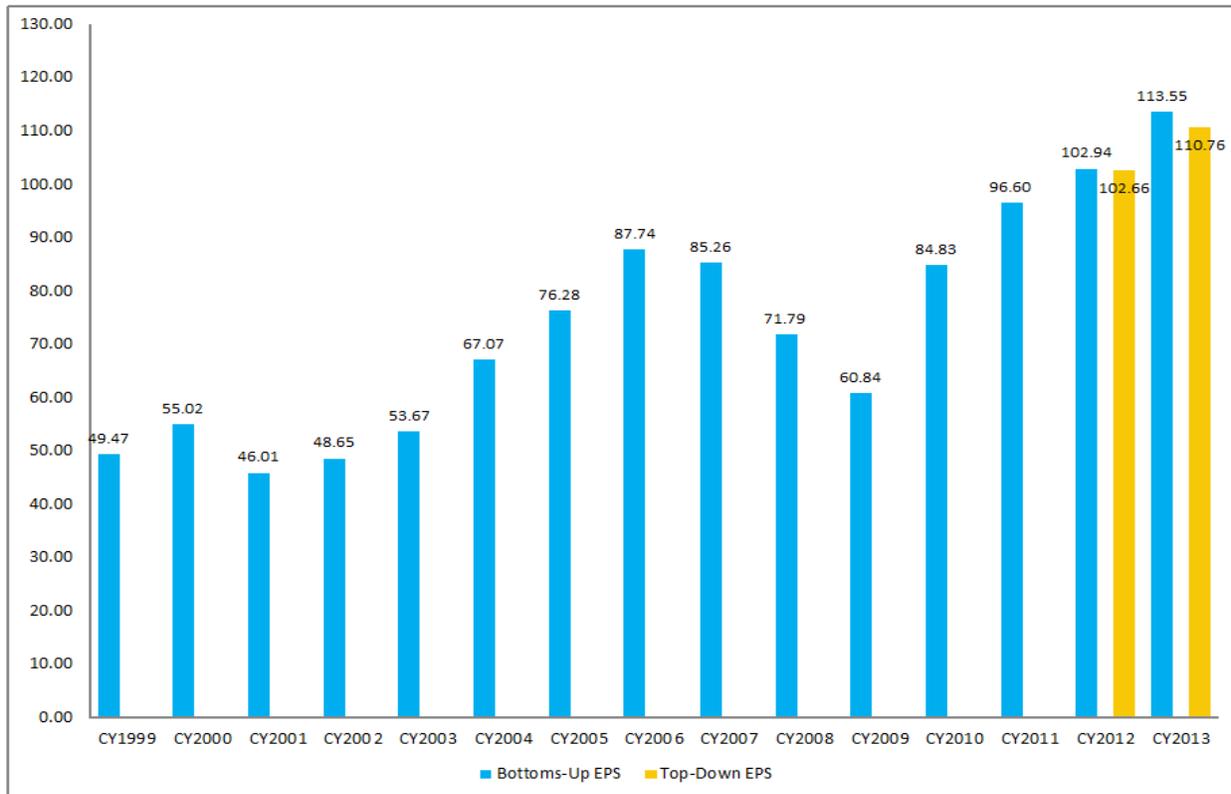


Change in Q312 and Q412 Bottom-Up EPS vs. Price (Trailing 26-Weeks)

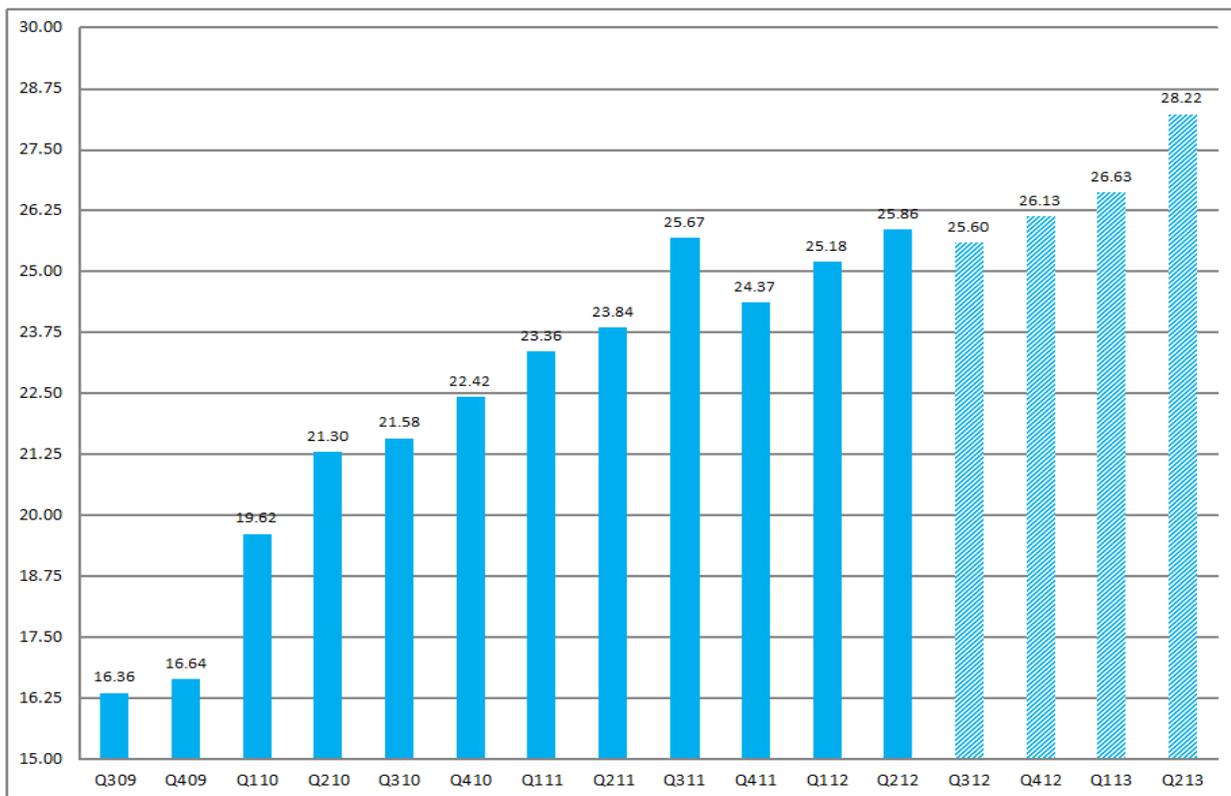


## Bottom-up Estimates: Current & Historical

Calendar Year Bottom-Up EPS Actuals & Estimates

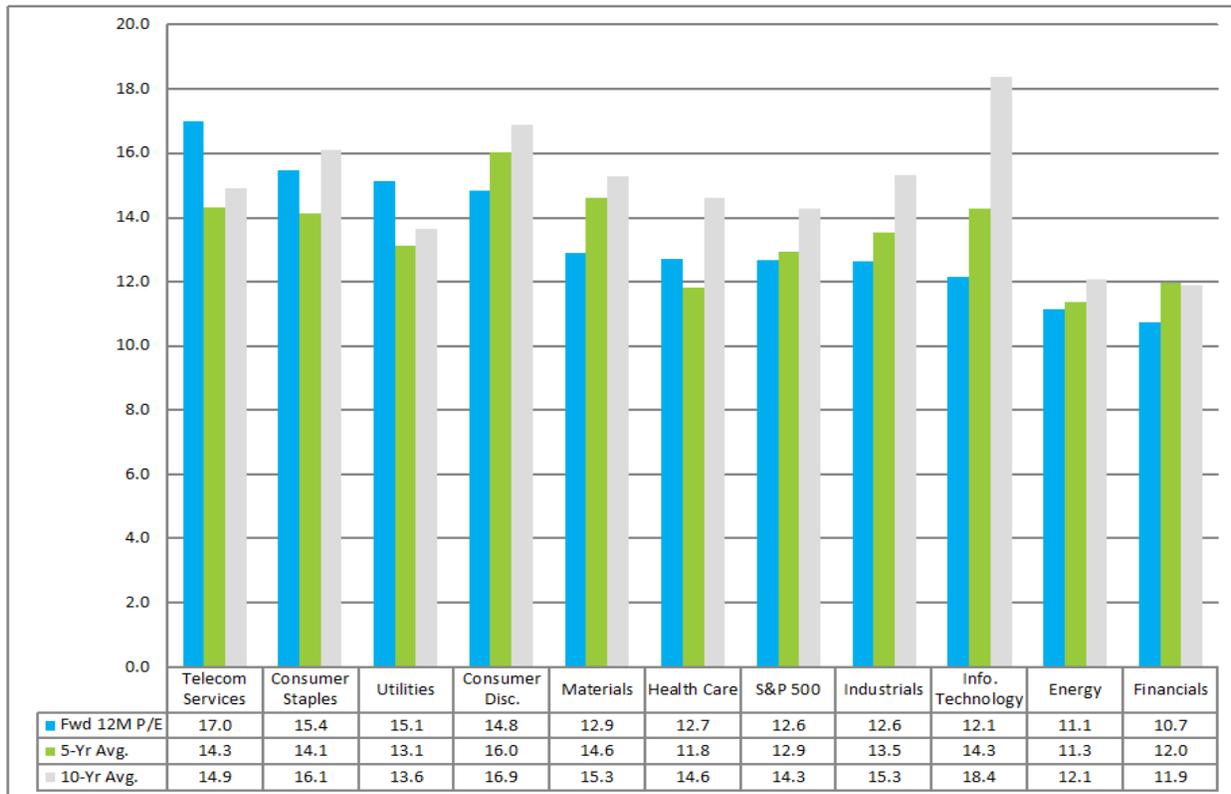


Calendar Year Bottom-Up EPS Actuals & Estimates

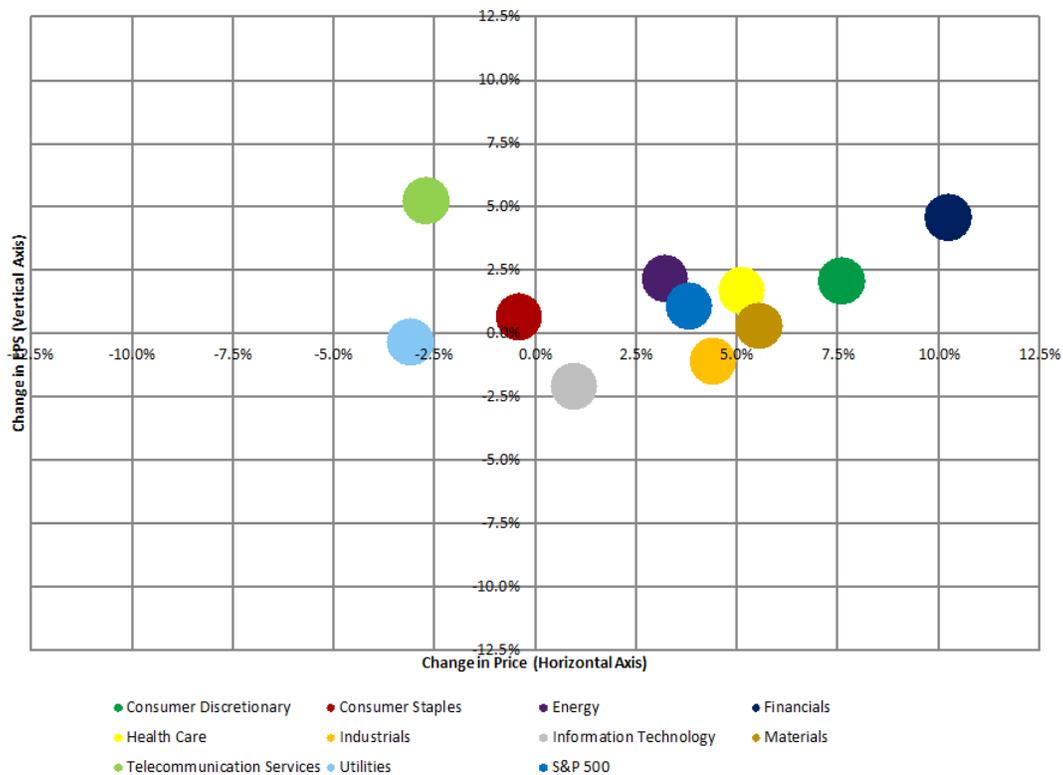


## Price / Earnings Ratio: Sector Level

Sector-Level Forward 12-Month P/E Ratios

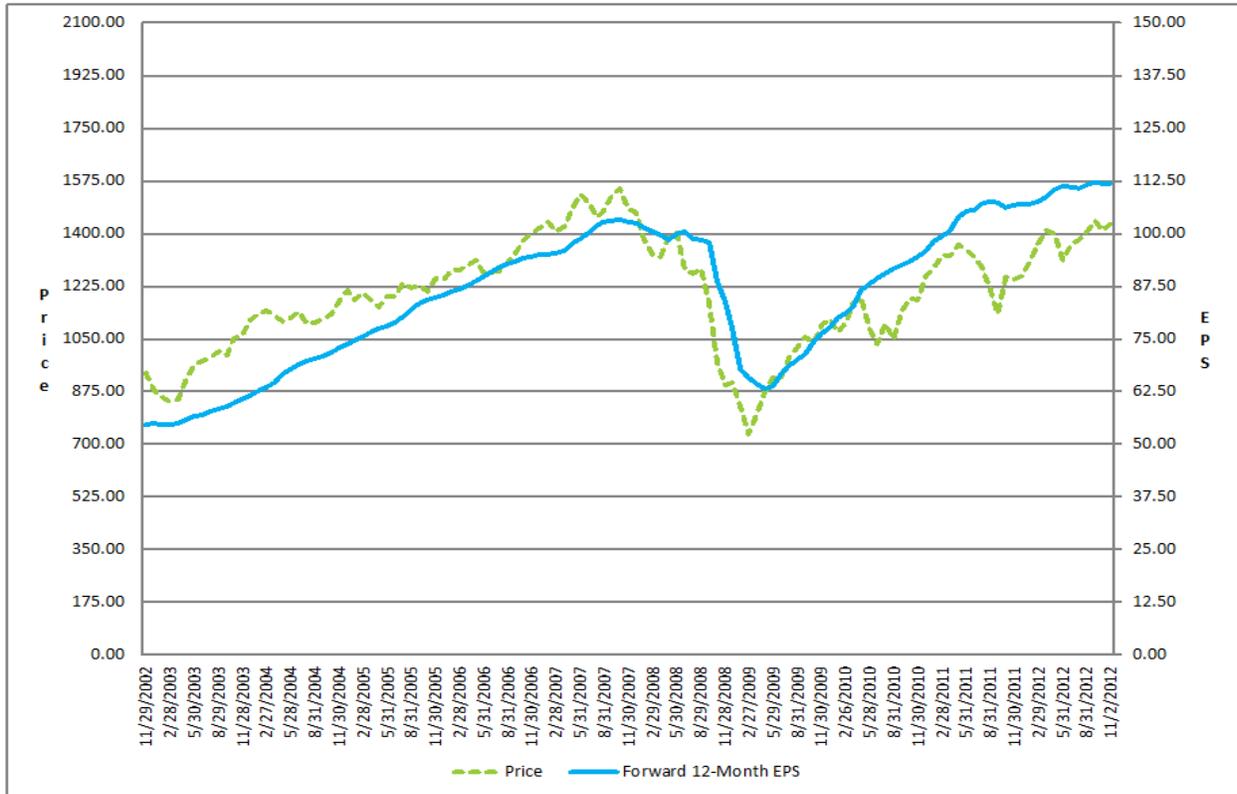


Sector-Level Change in Price vs. Change Forward 12M EPS: 3-Months

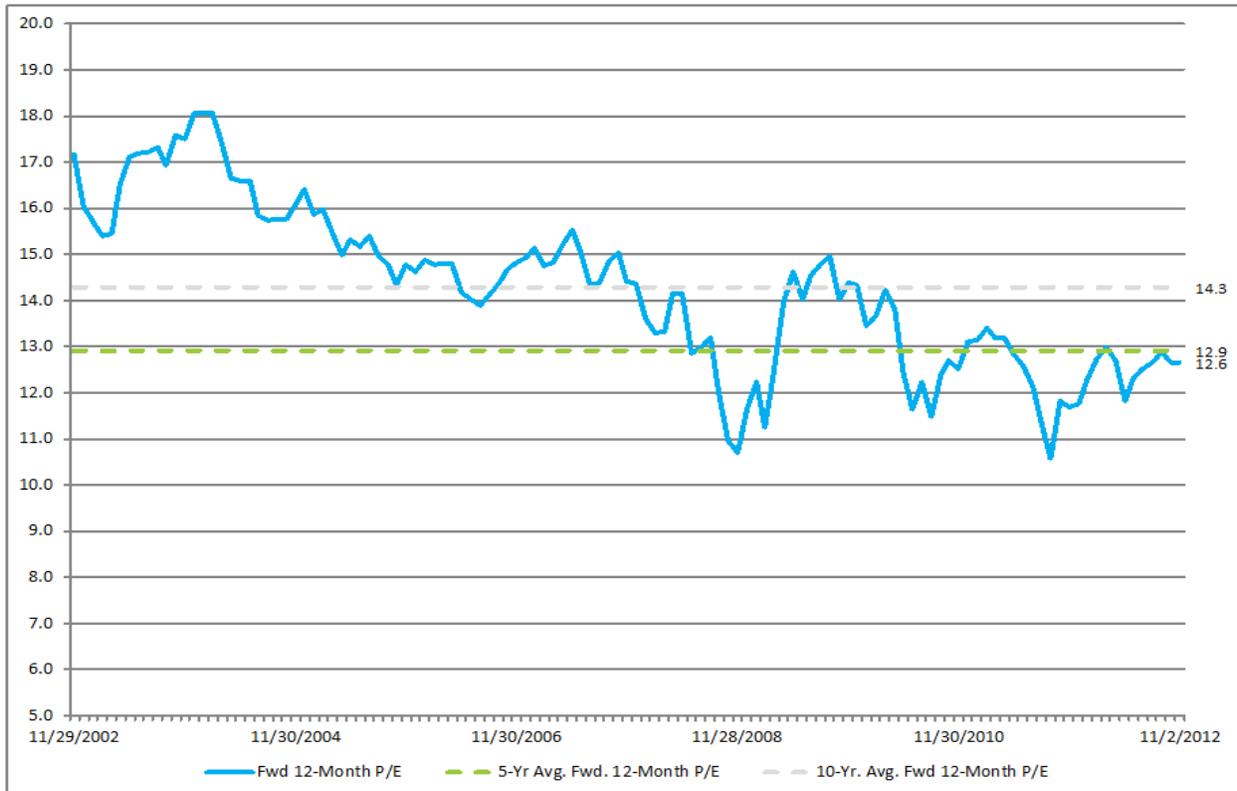


## Price / Earnings Ratio: Long-Term Averages

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



Forward 12M P/E Ratio: 10-Years



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