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EARNINGS INSIGHT

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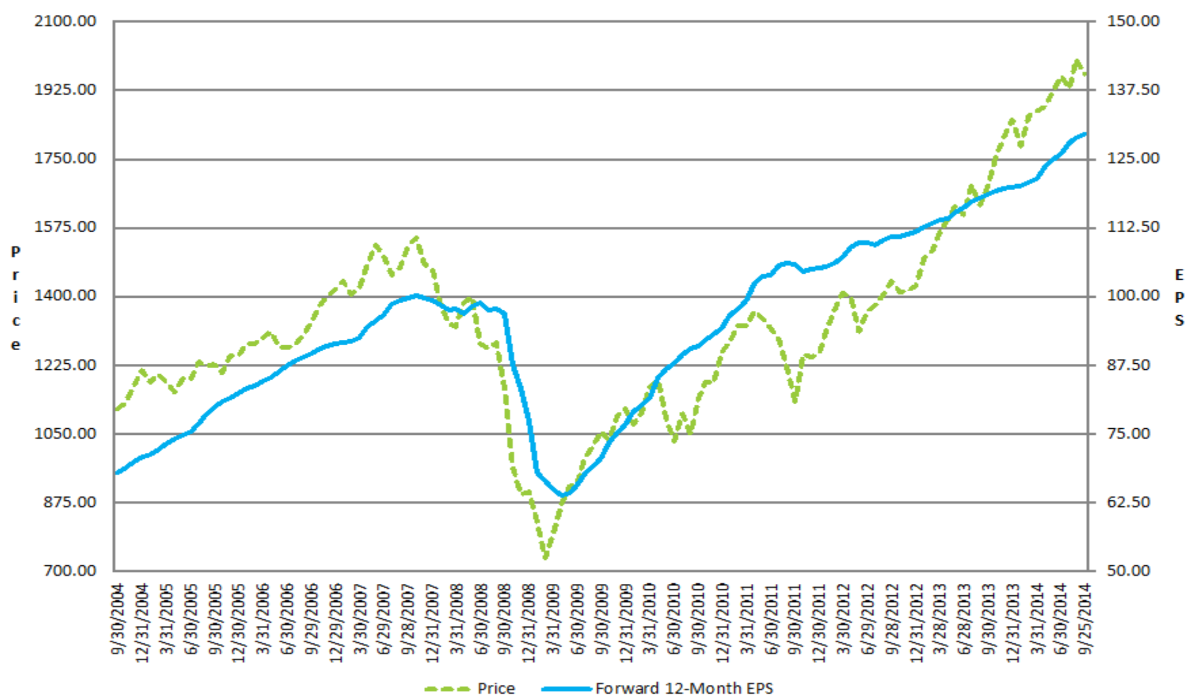
S&P 500

September 26, 2014

Key Metrics

- **Earnings Growth:** The estimated earnings growth rate for Q3 2014 is 4.7%. The Telecom Services sector is expected to report the highest earnings growth for the quarter, while the Consumer Discretionary sector is the only sector expected to report a year-over-year decline in earnings.
- **Earnings Revisions:** On June 30, the estimated earnings growth rate for Q3 2014 was 8.9%. Nine of the ten sectors have lower growth rates today (compared to June 30) due to downward revisions to earnings estimates, led by the Financials sector.
- **Earnings Guidance:** For Q3 2014, 83 companies have issued negative EPS guidance and 26 companies have issued positive EPS guidance.
- **Valuation:** The current 12-month forward P/E ratio is 15.2. This P/E ratio is based on Thursday's closing price (1965.99) and forward 12-month EPS estimate ($129.57).
- **Earnings Scorecard:** Of the 17 companies that have reported earnings to date for Q3 2014, 13 have reported earnings above the mean estimate and 12 have reported sales above the mean estimate.

Change in Forward 12-Month EPS vs. Change in Price: 10 Years
(Source: FactSet)



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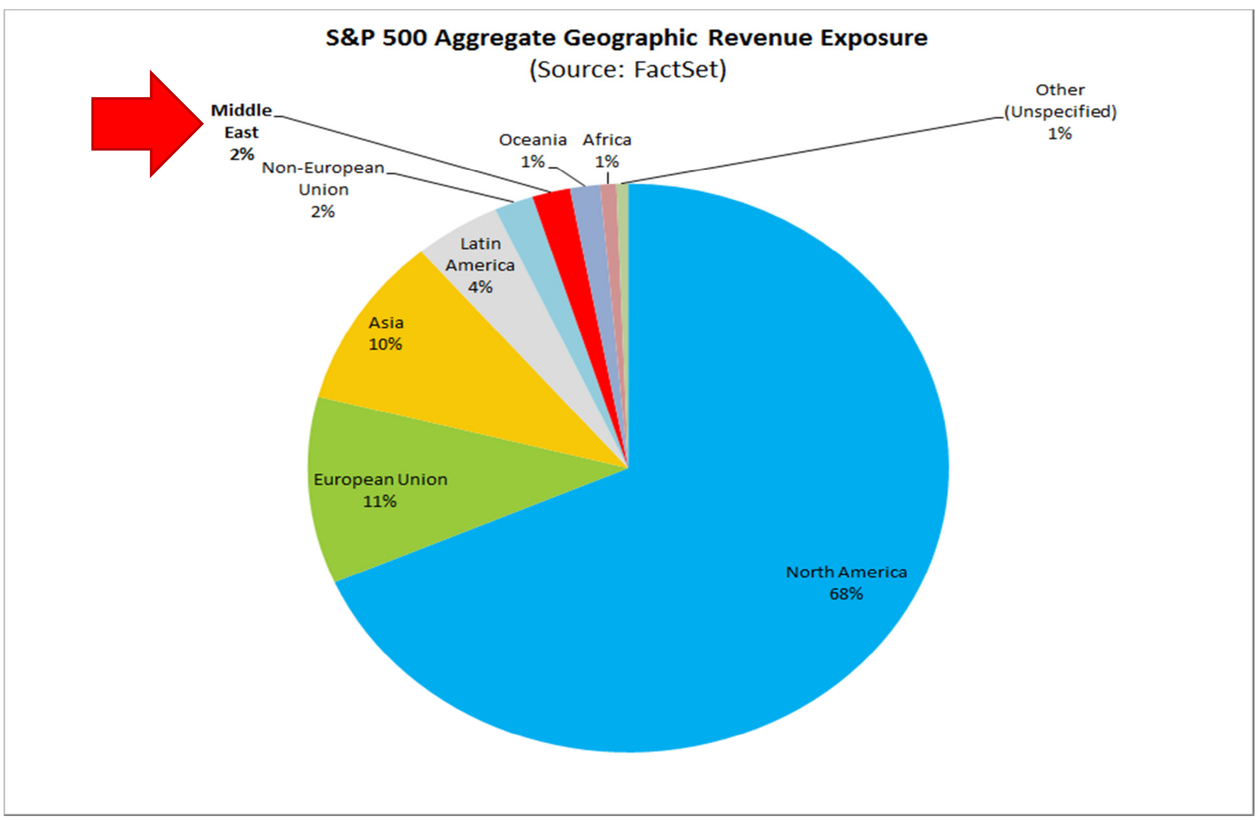
Topic of the Week

How Much Revenue Exposure Do S&P 500 Companies Have in the Middle East?

Over the past few weeks, the United States has escalated military actions in the Middle East to combat ISIS and other terrorist groups. During this same time frame, the value of the S&P 500 has declined by 2.1% (to 1965.99 yesterday from 2007.71 on September 5). With the peak weeks of the Q3 2014 earnings season on the horizon, will the military conflict in the Middle East have a direct impact on the expected revenue and earnings of companies in the S&P 500 for the third quarter? How much revenue exposure do S&P 500 companies have in the Middle East?

The answer to second question is very little impact. Based on the most recent FactSet Geographic Revenue exposure data (which provides a structuralized and normalized presentation of corporate revenue by geography), companies in the S&P 500 in aggregate generate only about 1.9% of their revenues from the Middle East region. Of the 8 classified regions, the Middle East region ranks as the 6th highest for revenue exposure for the S&P 500, above only the Oceania region (Australia, New Zealand, and the Pacific Islands) at 1.5% and Africa at 0.8%.

At the sector level within the S&P 500, the three sectors that generate the highest percentage of revenue in aggregate from the Middle East region are the Industrials (3.7%), Information Technology (3.5%), and Energy (3.2%) sectors. At the industry level, the three industries that generate the highest percentage of revenue in aggregate from the Middle East region are the Tobacco (6.5%), Construction & Engineering (6.3%), and Industrial Conglomerates (6.0%) industries. Thus, revenue exposure to the Middle East region is limited for the S&P 500 even at the sector and industry levels.



Q3 2014 Earnings Season: Overview

Estimated Earnings Growth Rate Cut Nearly in Half since June 30

Little change in Estimated Earnings Growth Rate This Week

The estimated earnings growth rate for the third quarter is 4.7% this week, slightly above the estimated earnings growth rate of 4.6% last week. The small increase in the earnings growth rate this past week was mainly due to upside earnings surprises reported by NIKE and Carnival Corporation, partially offset by small downward revisions to earnings estimates for companies in the Energy sector (including Exxon Mobil and Chevron).

Financials Sector Has Seen Largest Cuts to Earnings Growth Estimates since June 30

The estimated earnings growth rate for Q3 2014 of 4.7% is below the estimate of 8.9% at the start of the quarter (June 30). Nine of the ten sectors have recorded a decline in expected earnings growth since the beginning of the quarter due to downward revisions to earnings estimates, led by the Financials and Energy sectors. The only sector that has recorded an increase in expected earnings growth since the start of the quarter is the Health Care sector.

The Financials sector has recorded the largest decline in expected earnings growth (to 9.9% from 20.5%) since the beginning of the quarter. At the company level, Bank of America has witnessed the largest decrease in expected earnings (to -$0.09 from $0.32) in the sector and accounts for most of the drop in the growth rate, as analysts have incorporated the negative impact of the company's settlement (announced on August 21) with the DOJ and other government entities into their EPS estimates. Despite the reduction in EPS, the price of the stock of the company has actually increased by 9.6% (to $16.85 from $15.37) since June 30. Over this same time frame, the price of the Financials sector as a whole has increased by 1.5% (to 311.17 from 306.61), which is the third highest increase in the price of any sector over this period.

The Energy sector has witnessed the second largest dip in expected earnings growth (to 4.0% from 11.9%) since the start of the quarter. At the company level, 40% of the companies in the sector have seen double-digit reductions to their EPS estimates during this time, led by Noble Energy (to $0.54 from $0.84), Noble Corporation (to $0.56 from $0.86), and EQT Corporation (to $0.65 from $0.91). Since June 30, the price of the Energy sector has declined by 8.8% (to 663.29 from 727.63), which is the largest price decrease of all ten sectors during this period.

Health Care: Only Sector to Record Increase in Expected Earnings Growth since June 30

On the other hand, the Health Care sector is the only sector that has witnessed an increase in expected earnings growth (to 10.6% from 9.4%) since the start of the quarter. At the company level, just 7% of the companies in this sector have recorded double-digit increases to EPS estimates during this time, led by Mallinckrodt (to $1.25 from $0.89), Gilead Sciences (to $1.92 from $1.50), Universal Health Services (to $1.39 from $1.21), and Biogen Idec (to $3.45 from $3.01). Since the start of the quarter, the value of the Health Care sector has jumped 5.5% (to 743.47 from 704.52), which is the highest increase in price of all ten sectors over this period.

Q3 EPS Guidance: Negative Guidance (76%) Above Average

At this point in time, 109 companies in the index have issued EPS guidance for the third quarter. Of these 109 companies, 83 have issued negative EPS guidance and 26 have issued positive EPS guidance. Thus, the percentage of companies issuing negative EPS guidance to date for the third quarter is 76% (83 out of 109). This percentage is above than the 5-year average of 66%.

For more details on guidance, please see the next edition of our "Guidance Quarterly" report, which will be published on September 30.

Estimated Earnings Growth: 4.7%

The estimated earnings growth rate for Q3 2014 is 4.7%. Nine sectors are expected to report higher earnings relative to a year ago. Four of these nine sectors are predicted to reported double-digit earnings growth, led by the Telecom Services, Materials, and Health Care sectors. On the other hand, the Consumer Discretionary sector is the only sector projected to report a year-over-year decline in earnings.

Telecom Services: Ex-Verizon, Growth Rate Drops to -5%

The Telecom Services sector is predicted to report the highest earnings growth rate of all ten sectors at 23.3%. At the company level, Verizon Communications is the only company within the sector projected to report growth in EPS for the quarter. The mean EPS estimate for the company for Q3 2014 is $0.93, compared to actual EPS of $0.77 in Q3 2013. If Verizon is excluded, the earnings growth rate for the sector would drop to -5.3%.

Materials: Strength in Chemicals Industry

The Materials sector is projected to report the second highest earnings growth rate at 11.0%. At the industry level, only three of the five industries are expected to report earnings growth, led by the Construction Materials (61%) and Chemicals (19%) industries. However, the Chemicals industry is by far the largest contributor to growth for the Materials sector. If this industry is excluded, the earnings growth rate for the sector would fall to -3.2%.

Health Care: Gilead Sciences Leads Growth

The Health Care sector is predicted to report the third highest earnings growth rate at 10.6%. At the company level, Gilead Sciences is expected to report the highest percentage growth in EPS in the sector. The mean EPS estimate for the company for Q3 2014 is $1.92, compared to actual EPS of $0.52 in Q3 2013. The company is also the largest contributor to earnings growth for the sector. If Gilead Sciences is excluded, the earnings growth rate for the sector would drop to 3.8%.

Consumer Discretionary: PulteGroup a Drag on Growth Due to Comparison to High Year-Ago EPS

The Consumer Discretionary sector is the only sector predicted to report a year-over-year decline in earnings at -4.7%. At the company level, PulteGroup is the largest contributor to the expected earnings decline for the sector, mainly due to a gain the company reported in the year-ago quarter. The company is expected to report EPS of $0.36 for Q3 2014, compared to actual EPS of $5.87 in the year-ago quarter. The unusually high EPS reported by PulteGroup in Q3 2013 included a deferred tax asset valuation allowance reversal (gain) of $5.42. If PulteGroup is excluded, the earnings growth rate for the sector would jump to 3.6%.

Estimated Revenue Growth: 3.7%

The estimated revenue growth rate for Q3 2014 is 3.7%, which is above the estimated growth rate of 3.5% at the start of the quarter (June 30). Upward revisions to revenue estimates for companies in the Energy and Health Care sectors, partially offset by downward revisions to revenue estimates for companies in the Consumer Discretionary, Financials, Industrials, and Materials sectors, have accounted for most of the improvement in the revenue growth rate for the index since the start of the quarter.

Overall, nine sectors are expected to report revenue growth for the quarter, led by the Health Care sector. The Energy sector is the only sector projected to see a year-over-year decline in revenues.

The Health Care sector is predicted to have the highest revenue growth of all ten sectors at 10.2%. All six industries in the sector are predicted to report sales growth for the quarter. Four of the six industries are expected to report double-digit sales growth, led by the Biotechnology (37%) industry.

On the other hand, the Energy (-2.9%) sector is the only sector projected to report a year-over-year decrease in sales for the quarter. Five of the seven sub-industries in the sector are predicted to report a decrease in revenue, led by the Coal & Consumable Fuels (-27%) sub-industry.

Higher Net Margins Projected for Q414 – Q215

While the estimated earnings growth rate for Q3 2014 is 4.7%, analysts do expect earnings growth for the S&P 500 to be much higher through the middle of 2015. For Q4 2014, Q1 2015, and Q2 2015, analysts are predicting earnings growth rates of 9.0%, 10.1%, and 11.1%, respectively. For all of 2014, the projected earnings growth rate is 7.4%. For all of 2015, the projected earnings growth rate is 11.4%.

However, revenue growth is not expected to improve dramatically over the next three quarters relative to expectations for Q3. The estimated revenue growth rate for Q3 2014 is 3.7%. For Q4 2014, Q1 2015, and Q2 2015, analysts are predicting revenue growth rates of 3.7%, 4.5%, and 3.7%. For all of 2014, the projected revenue growth rate is 3.9%. For all of 2015, the projected revenue growth rate is 4.3%.

Given this divergence in expected earnings and revenue growth over the next few quarters, analysts are expecting profit margins to continue to expand into 2015. Using the bottom-up sales-per-share (SPS) and earnings-per-share (EPS) estimates for the S&P 500 as proxies for expected sales and earnings for the index over the next few quarters, profit margin estimates can be calculated by dividing the expected EPS by the expected SPS for each quarter. Using this methodology, the estimated net profit margins for Q4 2014, Q1 2015, and Q2 2015 are 10.4%, 10.5%, and 10.9%. These numbers are above the estimated net profit margin for Q3 2014 (10.0%), and are also well above the average net profit margin of 9.3% recorded over the past four years.

Valuation: Forward P/E Ratio is 15.2, above the 10-Year Average (14.1)

The current 12-month forward P/E ratio is 15.2. This P/E ratio is based on Thursday’s closing price (1965.99) and forward 12-month EPS estimate ($129.57).

At the sector level, the Consumer Staples (17.6) and Consumer Discretionary (17.4) sectors have the highest forward 12-month P/E ratios, while the Financials (13.0), Energy (13.3), and Telecom Services (13.4) sectors have the lowest forward 12-month P/E ratios.

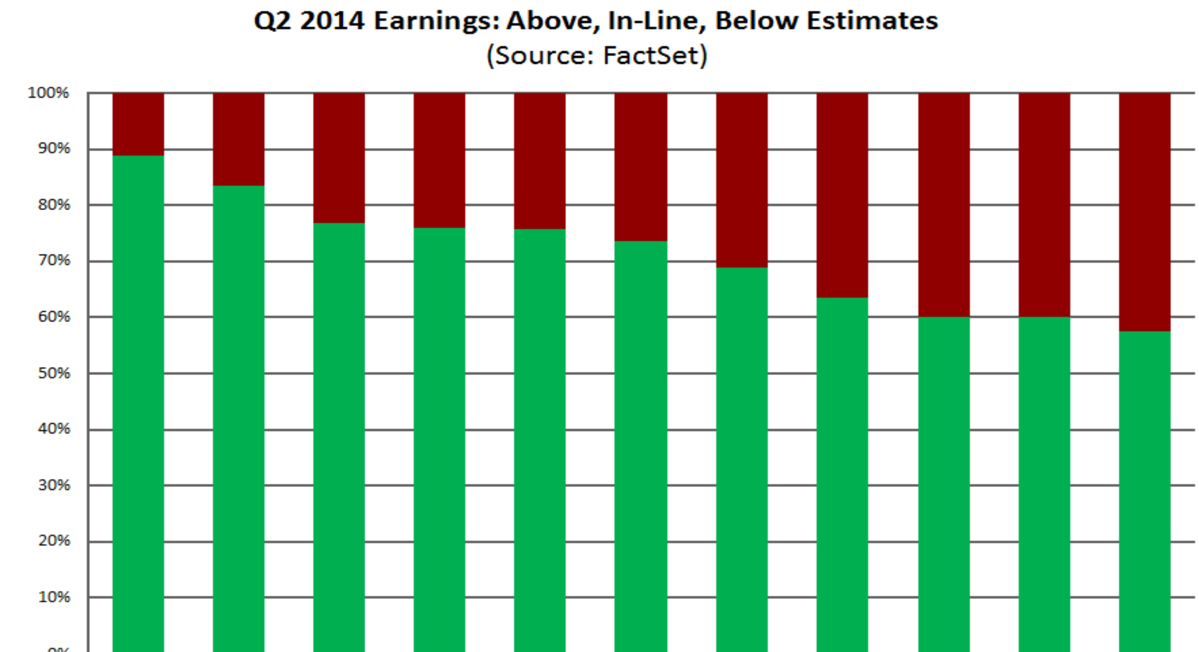
The P/E ratio of 15.2 for the index as a whole is above the prior 5-year average forward 12-month P/E ratio of 13.5, and above the prior 10-year average forward 12-month P/E ratio of 14.1. However, it is below the forward 12-month P/E ratio of 15.6 recorded at the start of the third quarter (June 30). During the quarter, the price of the index has increased by 0.3%, while the forward 12-month EPS estimate has increased by 2.8%.

At the sector level, one sector has recorded an increase in the forward 12-month P/E ratio since the start of the third quarter: Information Technology (to 15.3 from 15.2) sector. Eight sectors have recorded a decrease in the forward 12-month P/E ratio since the start of the third quarter, led by the Energy (to 13.3 from 14.7) and Utilities (to 15.5 from 16.6) sectors. One sector has the same forward 12-month P/E ratio today compared to the start of the third quarter: Telecom Services (13.4).

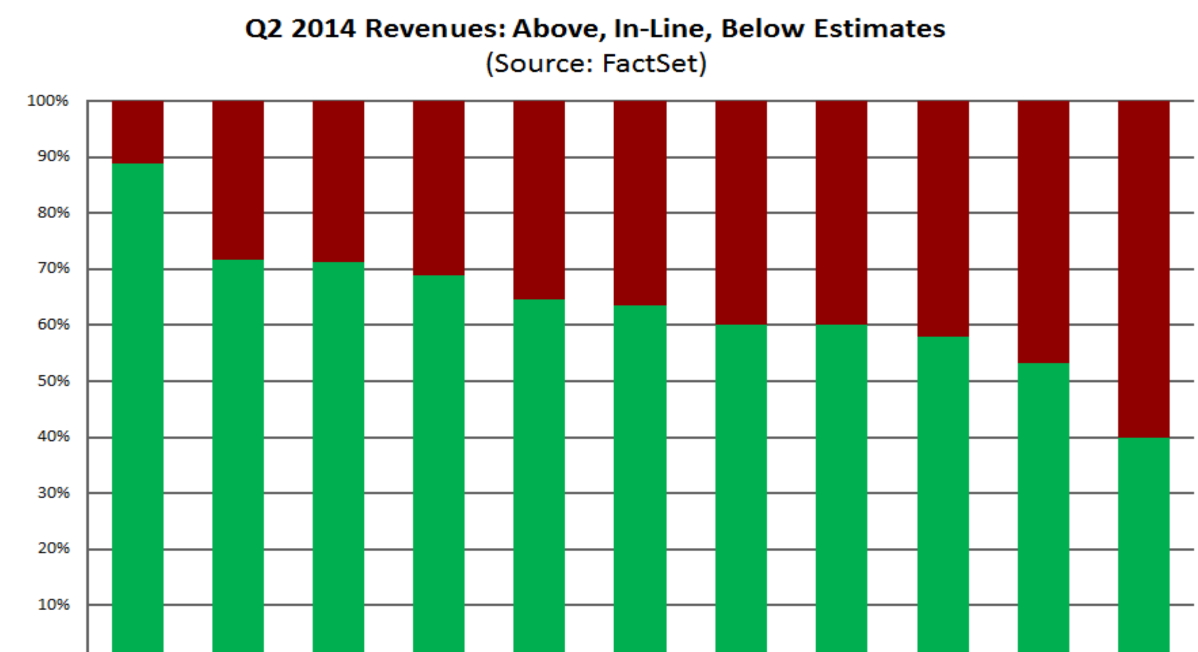
Companies Reporting Next Week: 5

During the upcoming week, five S&P 500 companies are scheduled to report earnings for the third quarter.

Q2 2014: Scorecard

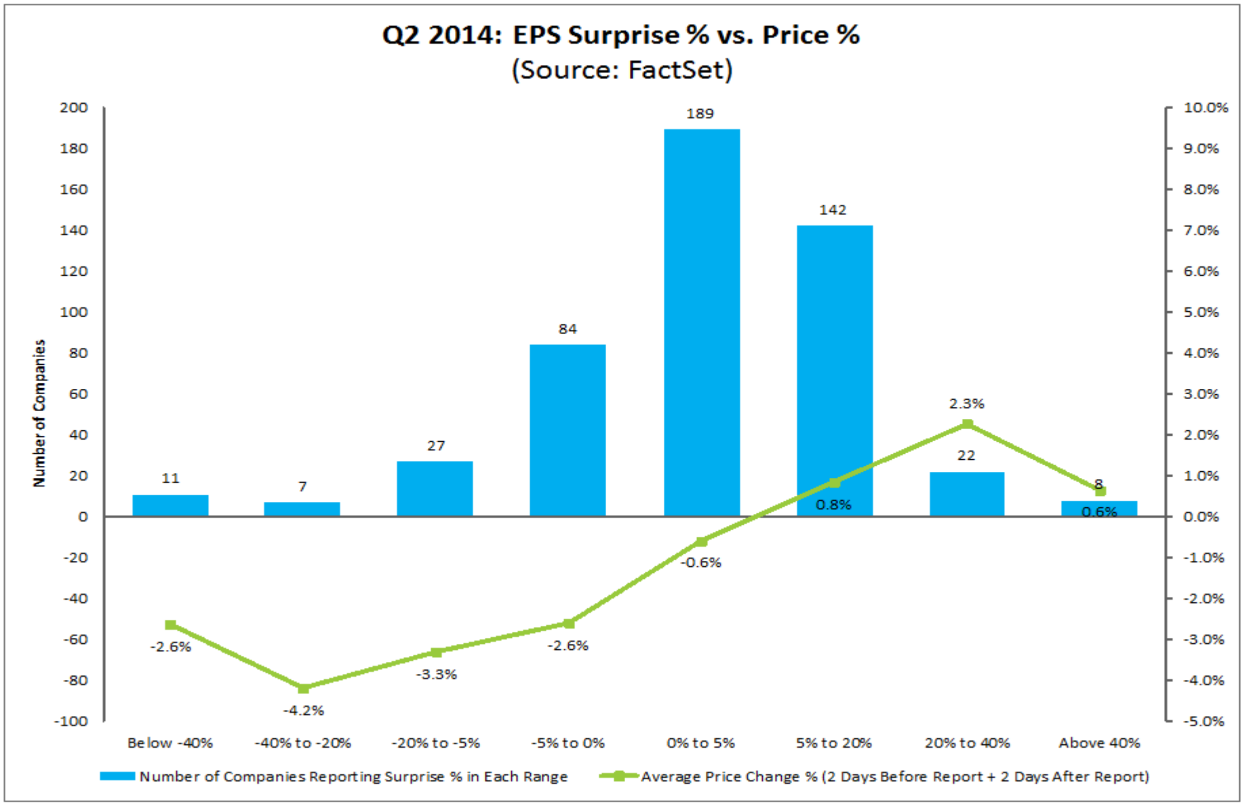


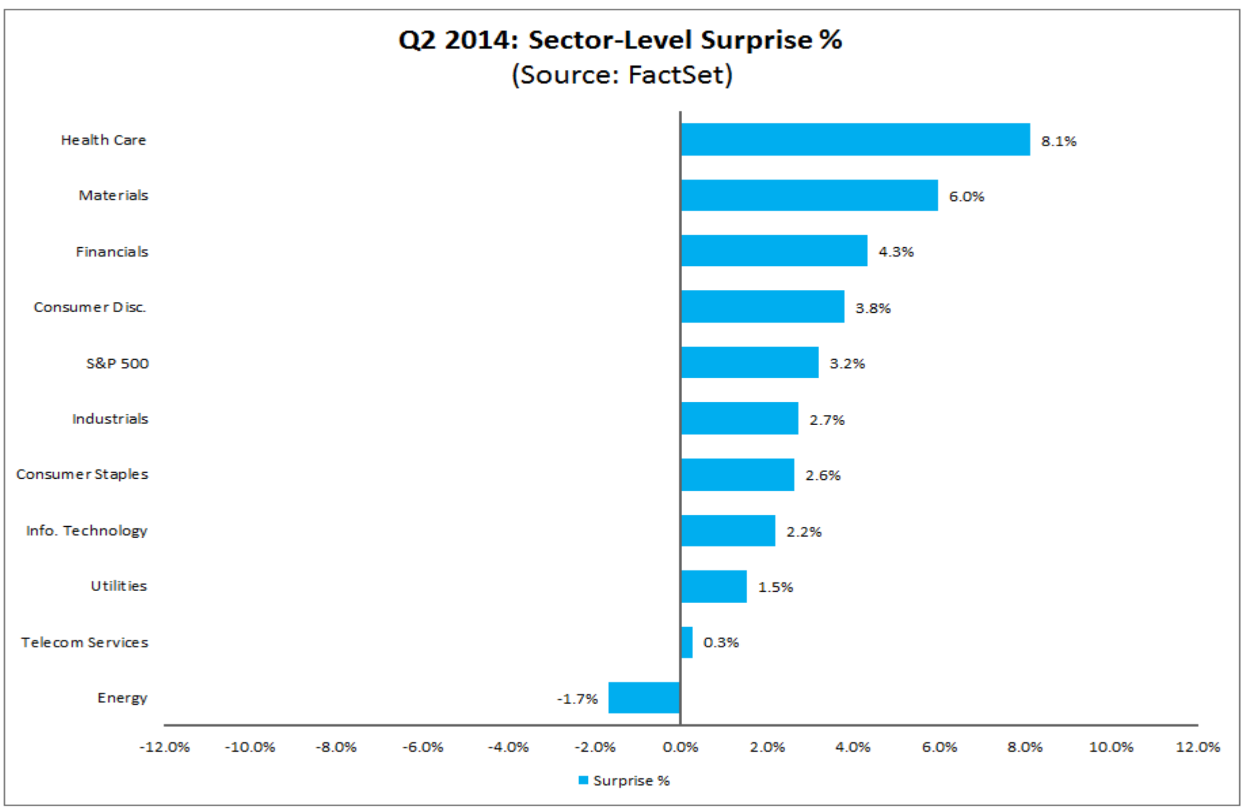
	Health Care	Info. Technology	Materials	Consumer Disc.	Financials	S&P 500	Industrials	Utilities	Energy	Telecom Services	Consumer Staples
Below	11%	17%	23%	24%	24%	27%	31%	37%	40%	40%	43%
In-Line	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Above	89%	83%	77%	76%	76%	73%	69%	63%	60%	60%	58%



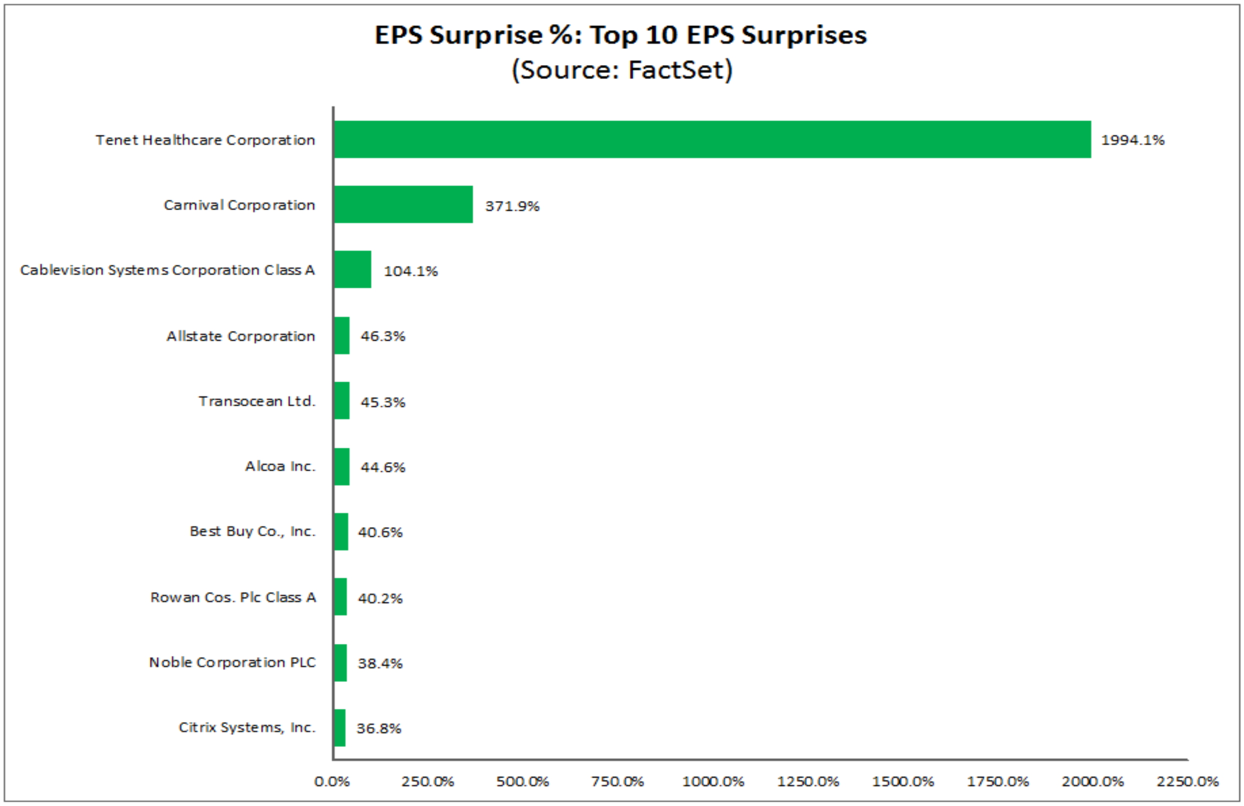
	Health Care	Financials	Info. Technology	Energy	S&P 500	Utilities	Materials	Telecom Services	Consumer Disc.	Industrials	Consumer Staples
Below	11%	28%	29%	31%	35%	37%	40%	40%	42%	47%	60%
In-Line	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Above	89%	72%	71%	69%	65%	63%	60%	60%	58%	53%	40%

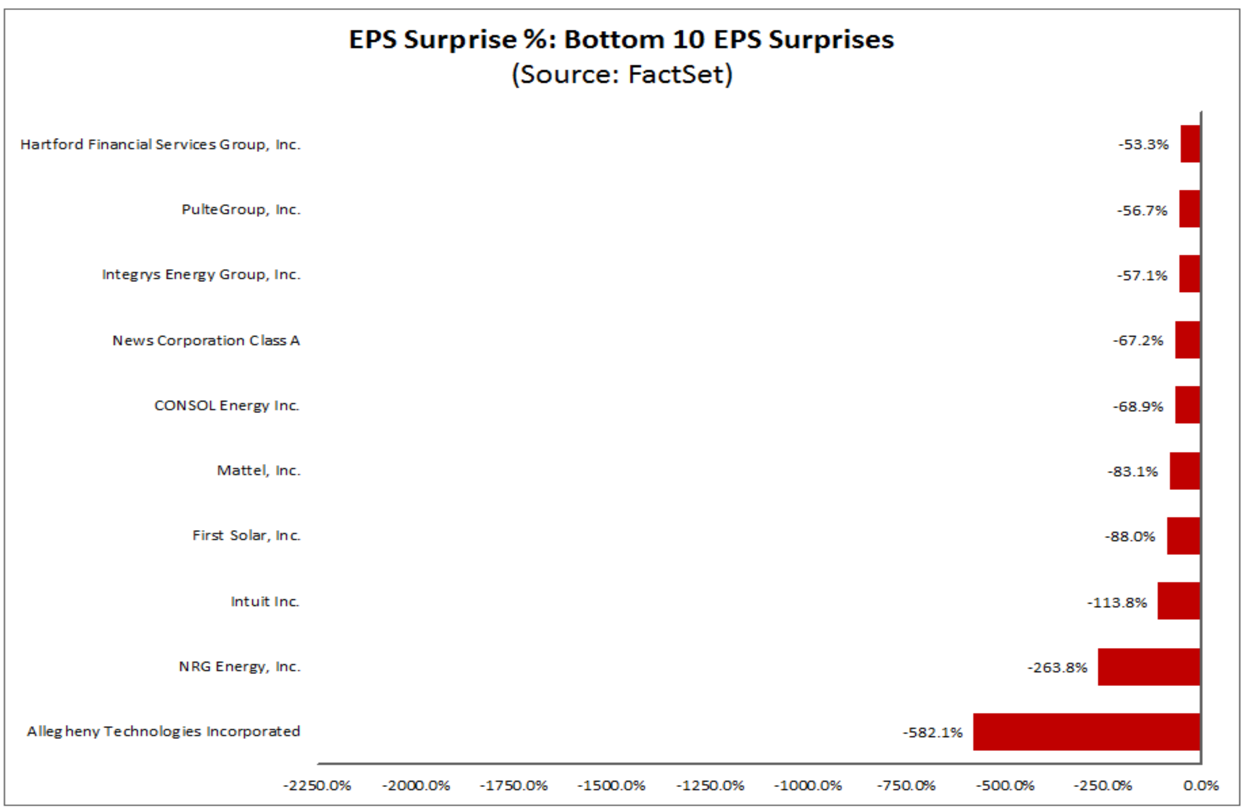
Q2 2014: Scorecard



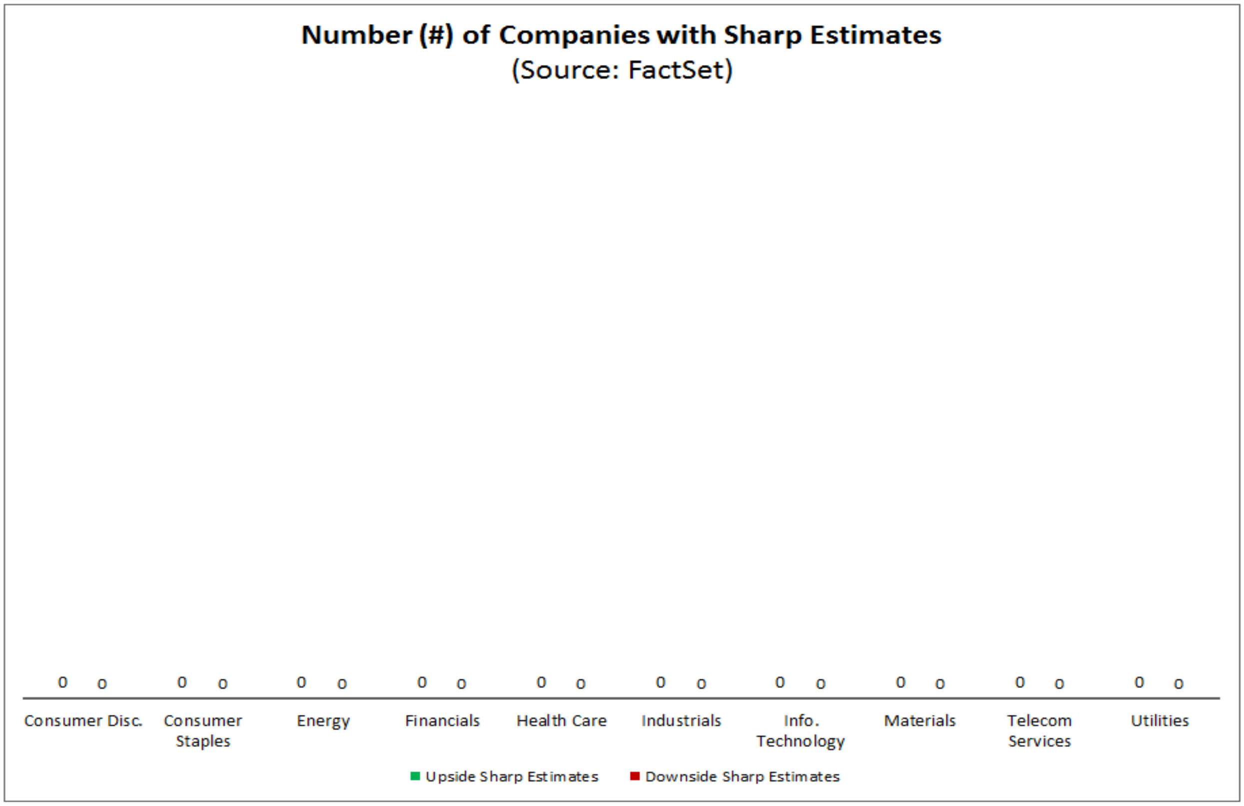


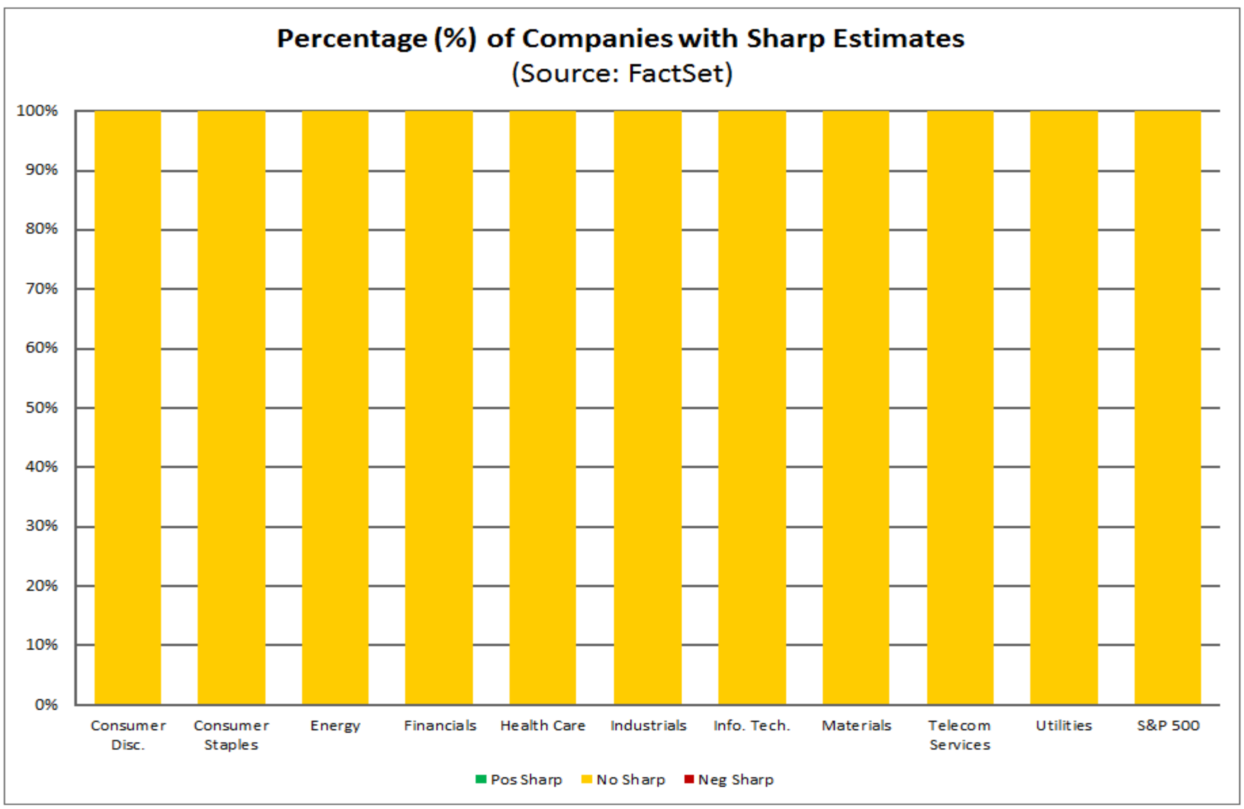
Q2 2014: Scorecard



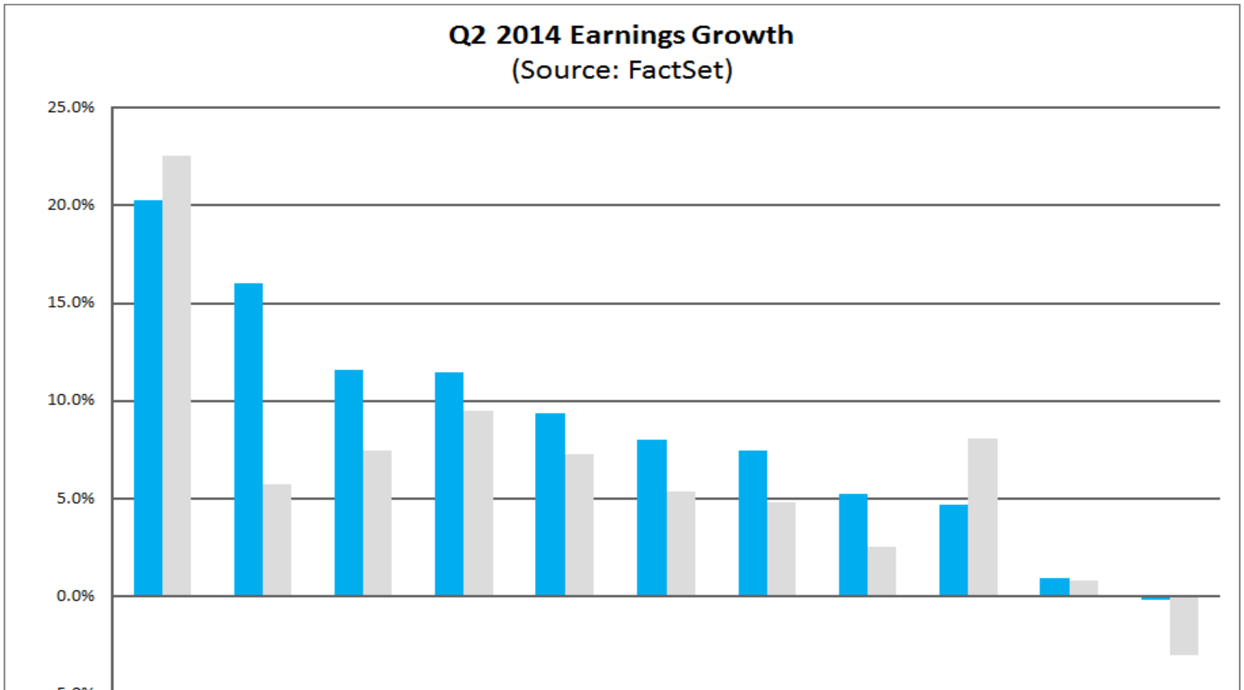


Q2 2014: Projected EPS Surprises (Sharp Estimates)

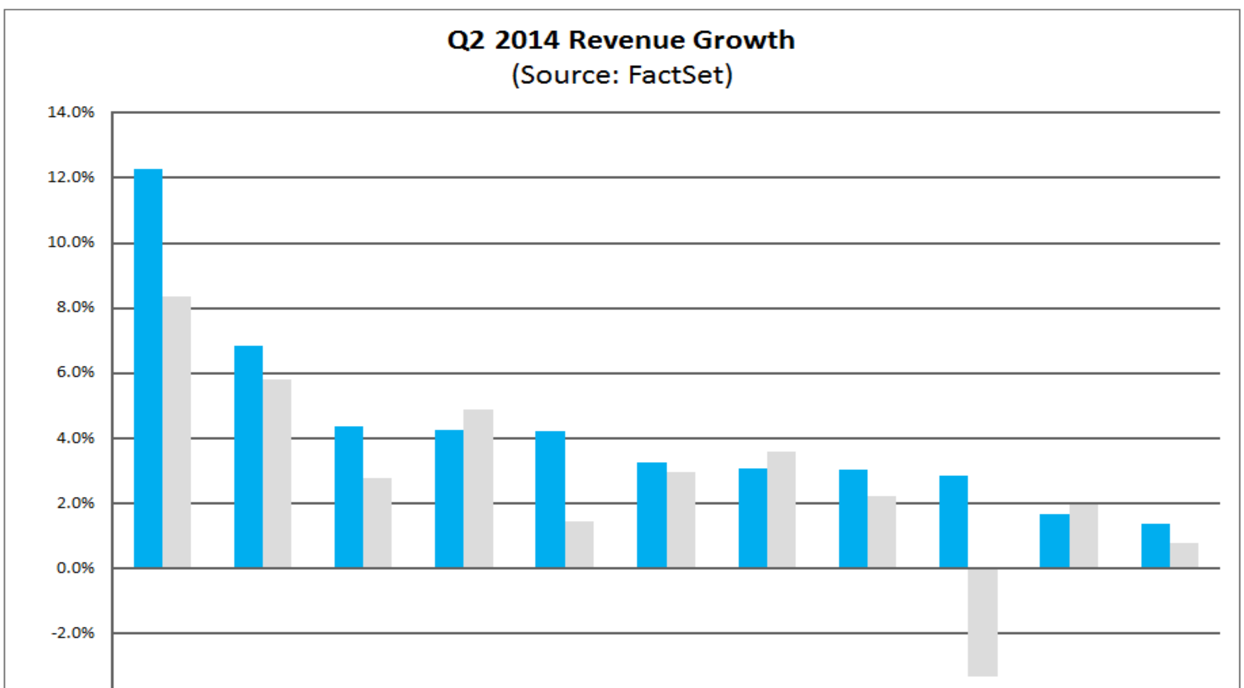




Q2 2014: Growth

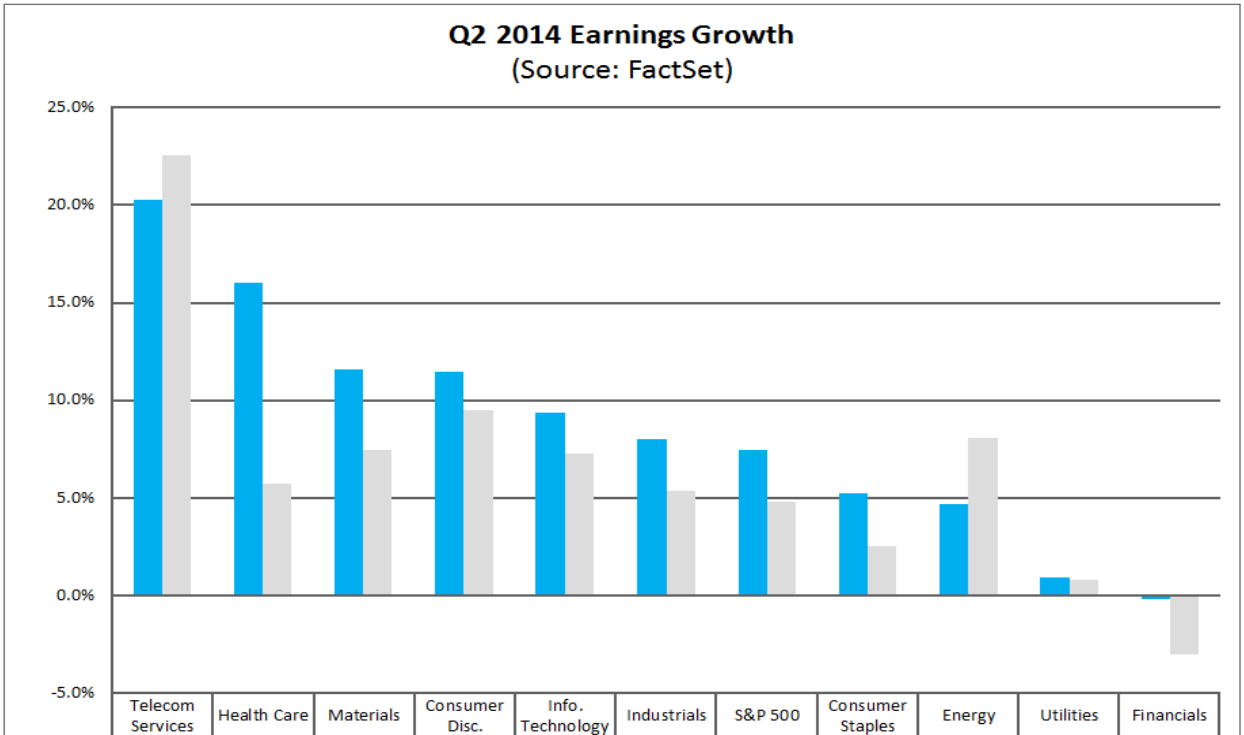


	Telecom Services	Health Care	Materials	Consumer Disc.	Info. Technology	Industrials	S&P 500	Consumer Staples	Energy	Utilities	Financials
Today	20.3%	16.0%	11.5%	11.4%	9.3%	8.0%	7.5%	5.3%	4.7%	1.0%	-0.2%
30-Jun	22.5%	5.7%	7.5%	9.5%	7.3%	5.4%	4.9%	2.6%	8.1%	0.8%	-3.0%

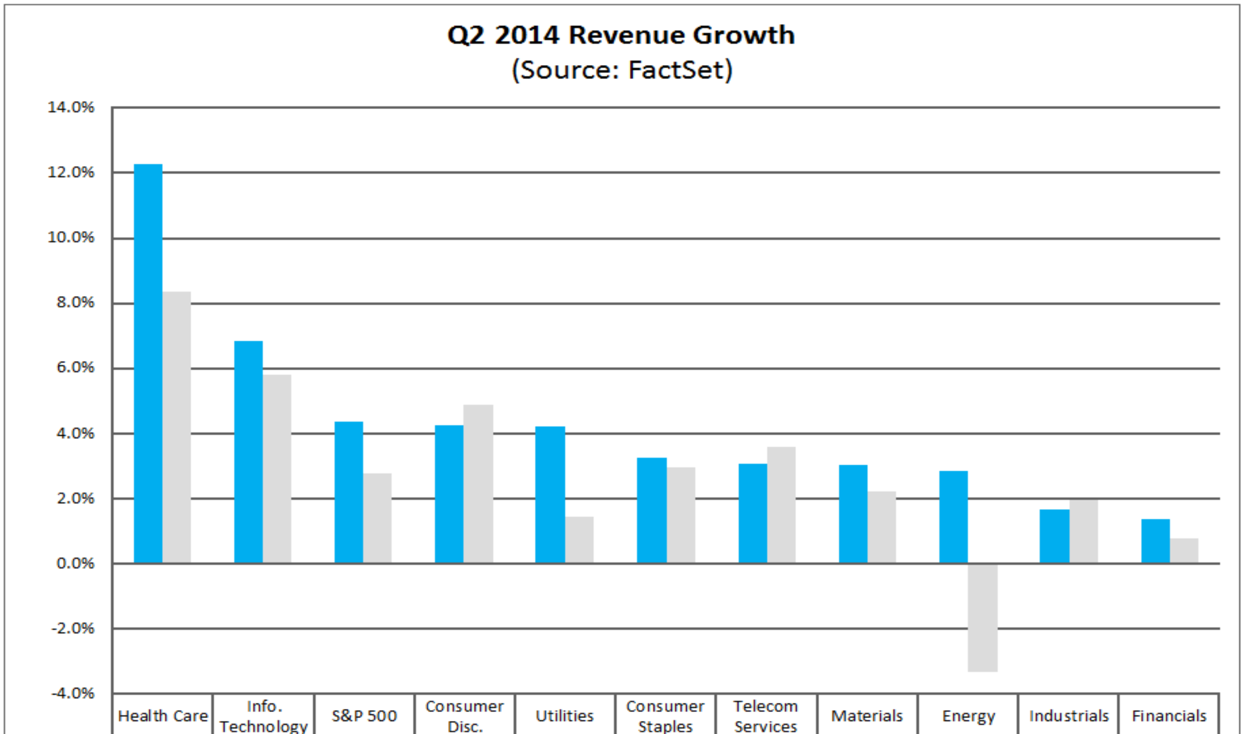


	Health Care	Info. Technology	S&P 500	Consumer Disc.	Utilities	Consumer Staples	Telecom Services	Materials	Energy	Industrials	Financials
Today	12.2%	6.8%	4.4%	4.2%	4.2%	3.3%	3.1%	3.1%	2.9%	1.7%	1.4%
30-Jun	8.3%	5.8%	2.8%	4.9%	1.4%	3.0%	3.6%	2.2%	-3.3%	2.0%	0.8%

Q2 2014: Growth

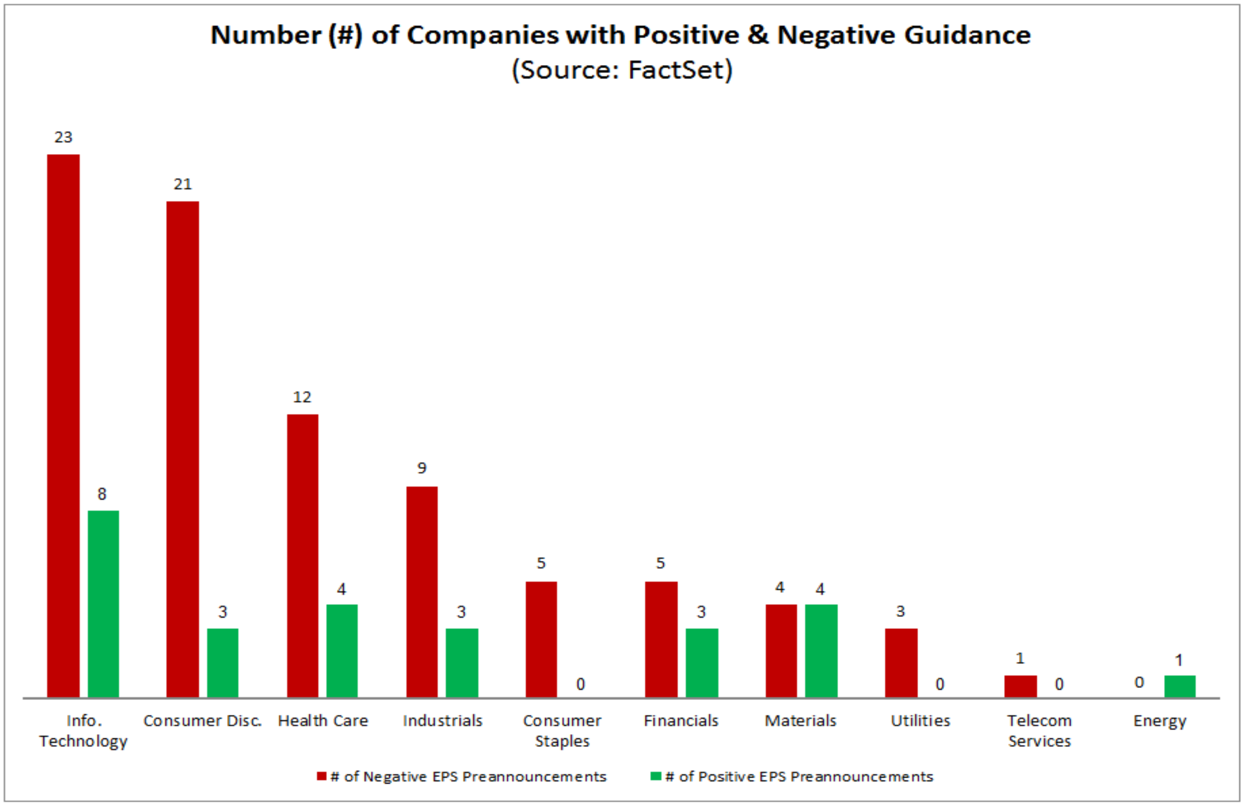


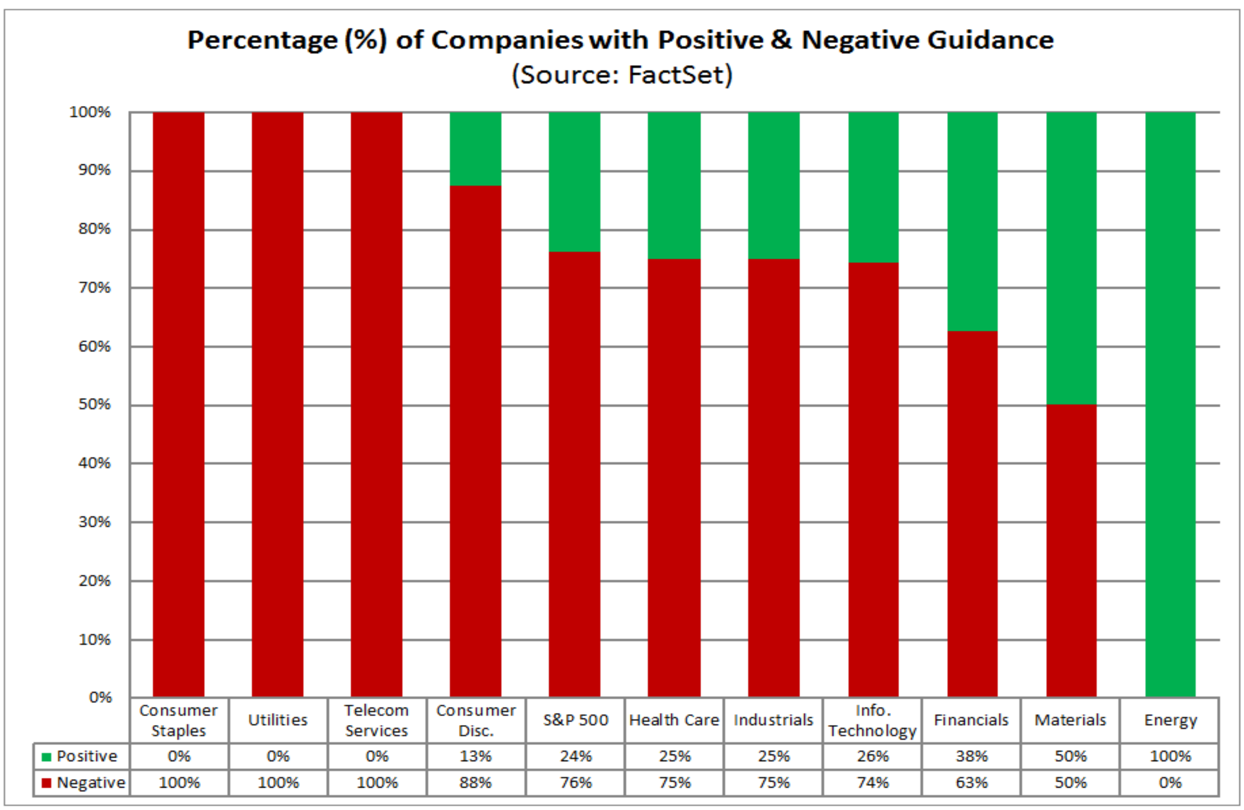
	Telecom Services	Health Care	Materials	Consumer Disc.	Info. Technology	Industrials	S&P 500	Consumer Staples	Energy	Utilities	Financials
Today	20.3%	16.0%	11.5%	11.4%	9.3%	8.0%	7.5%	5.3%	4.7%	1.0%	-0.2%
30-Jun	22.5%	5.7%	7.5%	9.5%	7.3%	5.4%	4.9%	2.6%	8.1%	0.8%	-3.0%



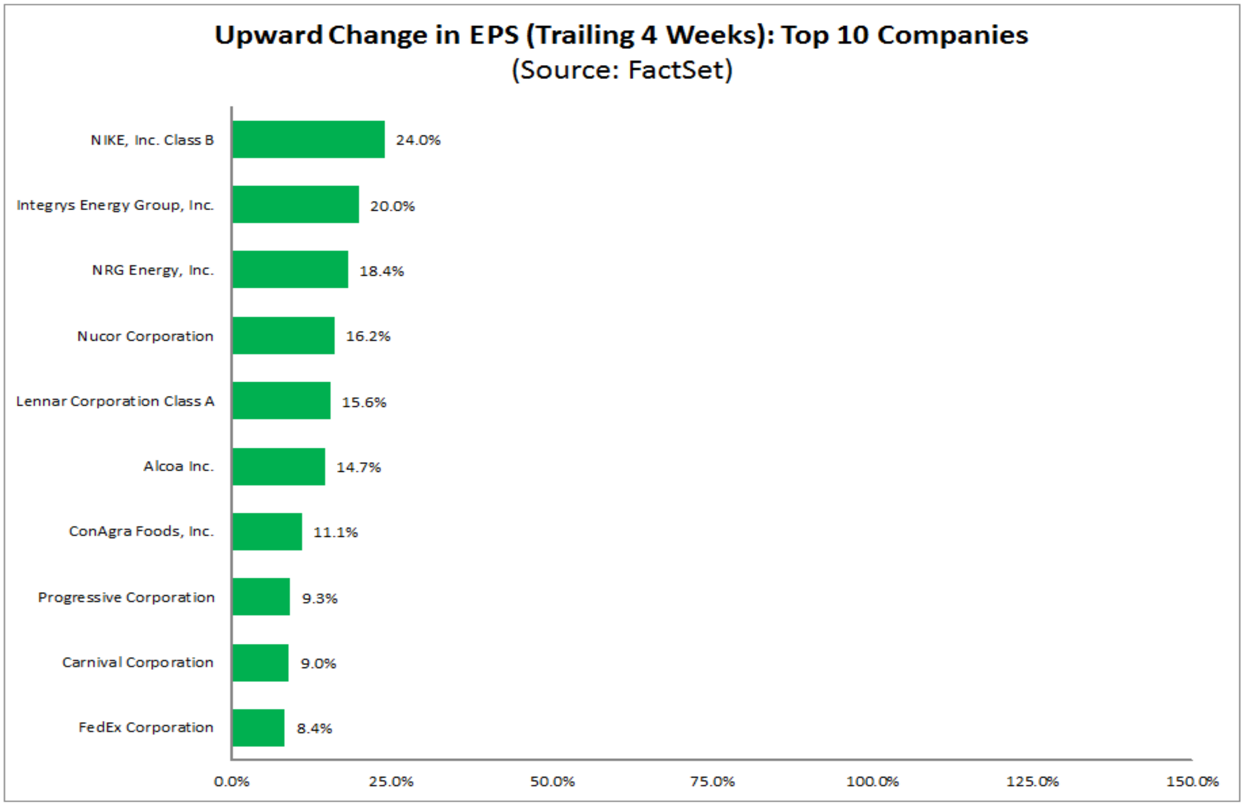
	Health Care	Info. Technology	S&P 500	Consumer Disc.	Utilities	Consumer Staples	Telecom Services	Materials	Energy	Industrials	Financials
Today	12.2%	6.8%	4.4%	4.2%	4.2%	3.3%	3.1%	3.1%	2.9%	1.7%	1.4%
30-Jun	8.3%	5.8%	2.8%	4.9%	1.4%	3.0%	3.6%	2.2%	-3.3%	2.0%	0.8%

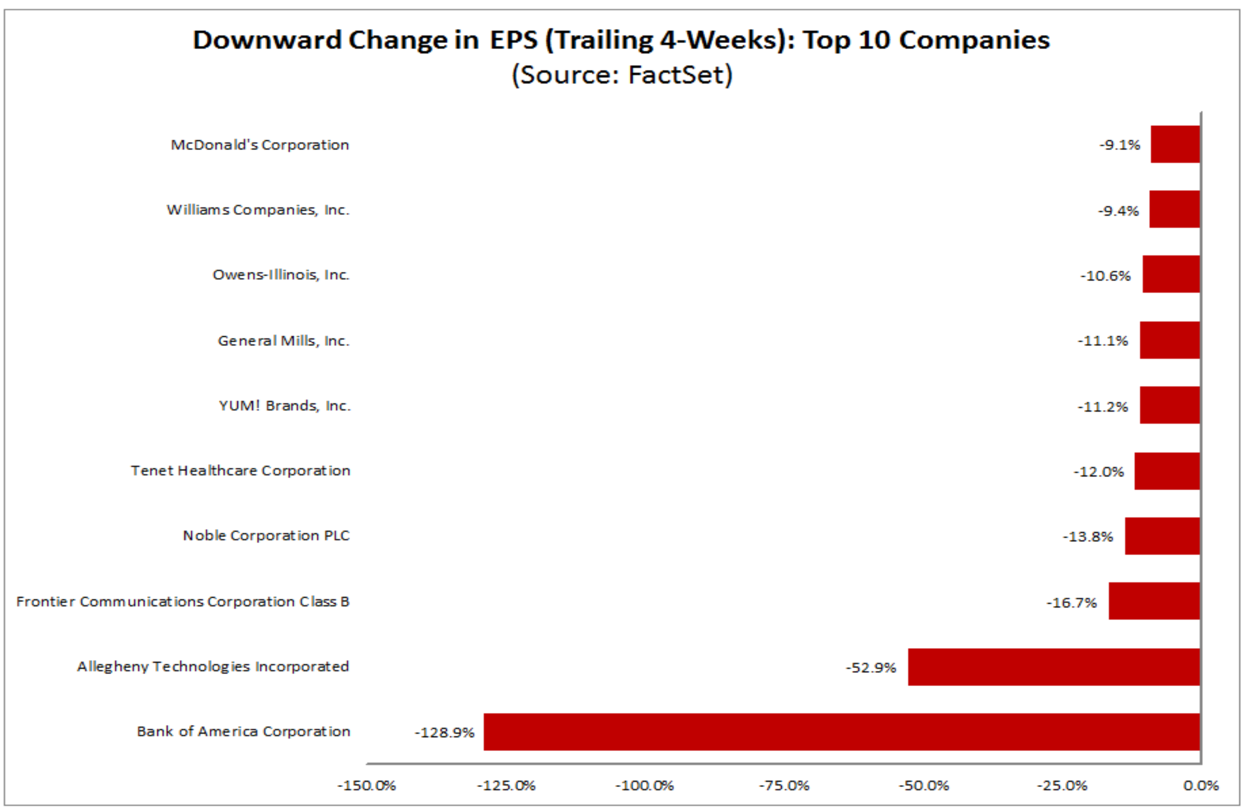
Q3 2014: EPS Guidance





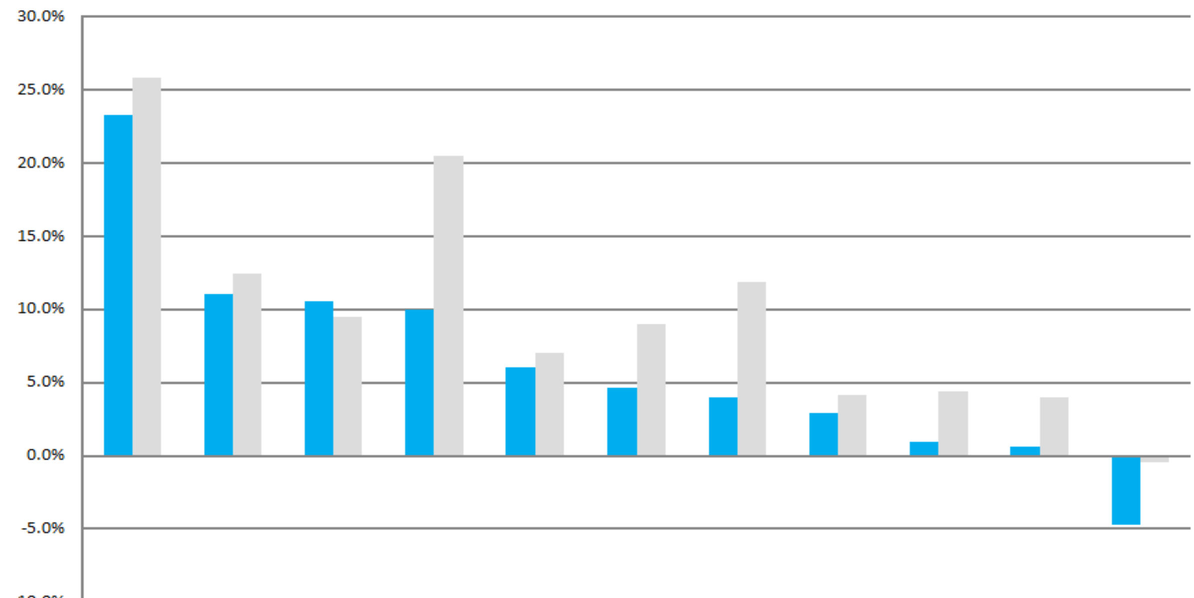
Q3 2014: EPS Revisions





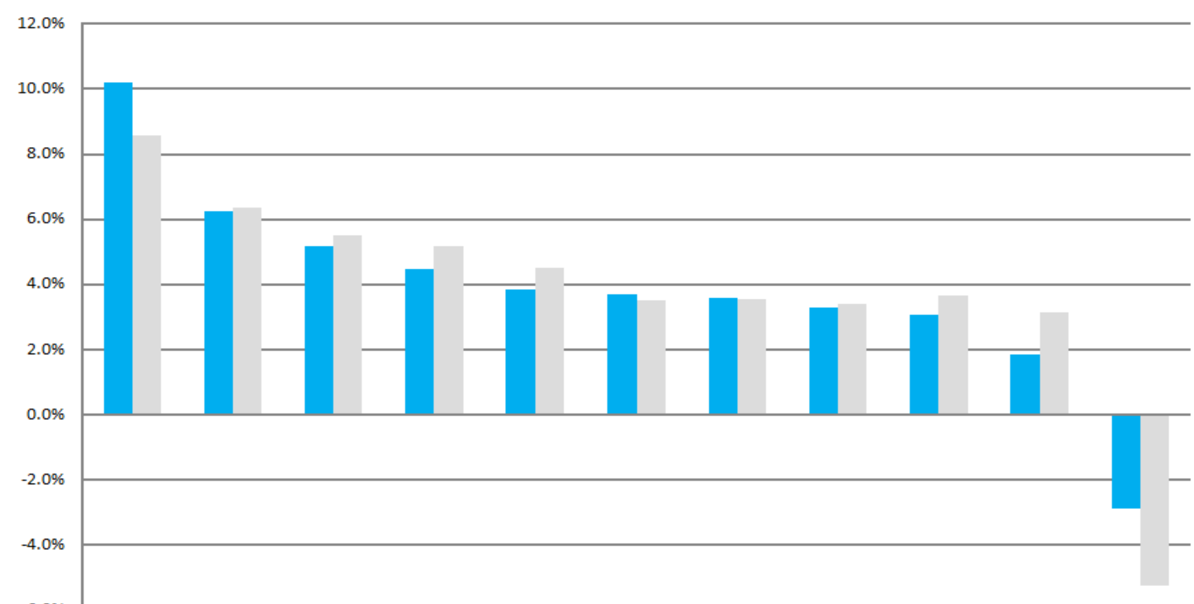
Q3 2014: Growth

Q3 2014: Earnings Growth
(Source: FactSet)



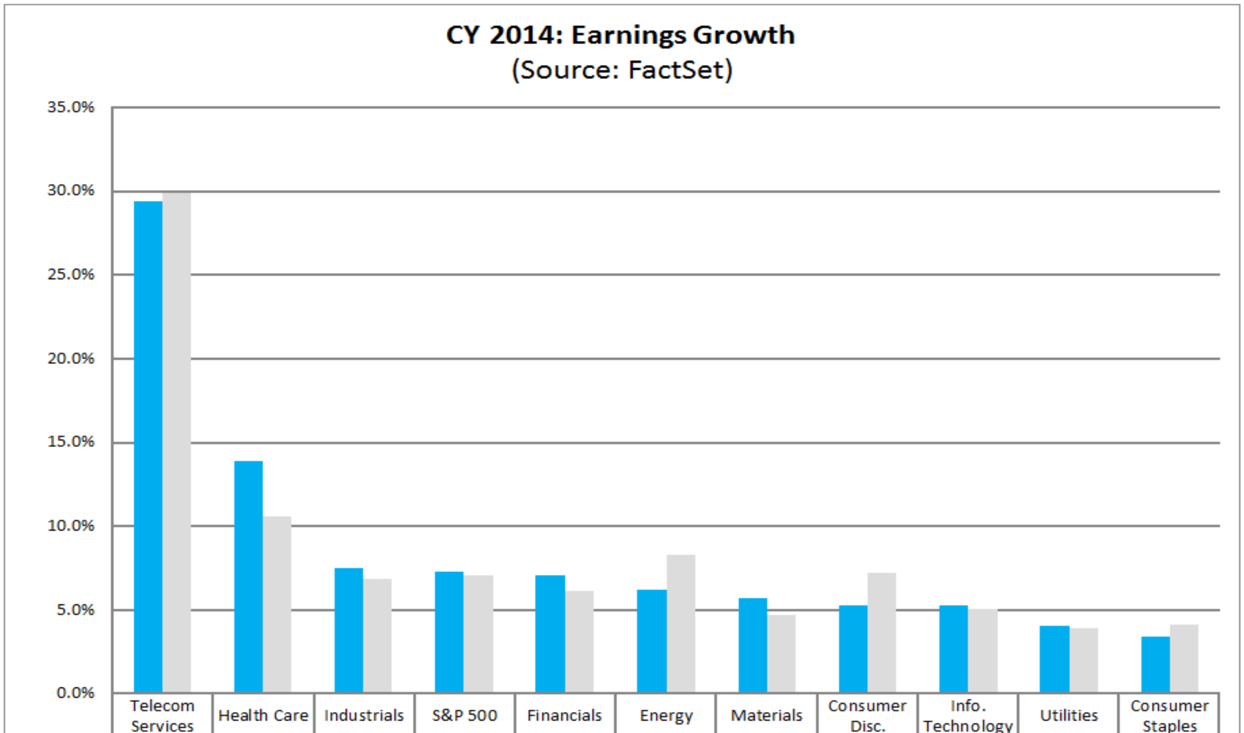
	Telecom Services	Materials	Health Care	Financials	Industrials	S&P 500	Energy	Utilities	Consumer Staples	Info. Technology	Consumer Disc.
Today	23.3%	11.0%	10.6%	9.9%	6.1%	4.7%	4.0%	3.0%	1.0%	0.7%	-4.7%
30-Jun	25.8%	12.4%	9.4%	20.5%	7.1%	8.9%	11.9%	4.2%	4.4%	4.0%	-0.4%

Q3 2014: Revenue Growth
(Source: FactSet)

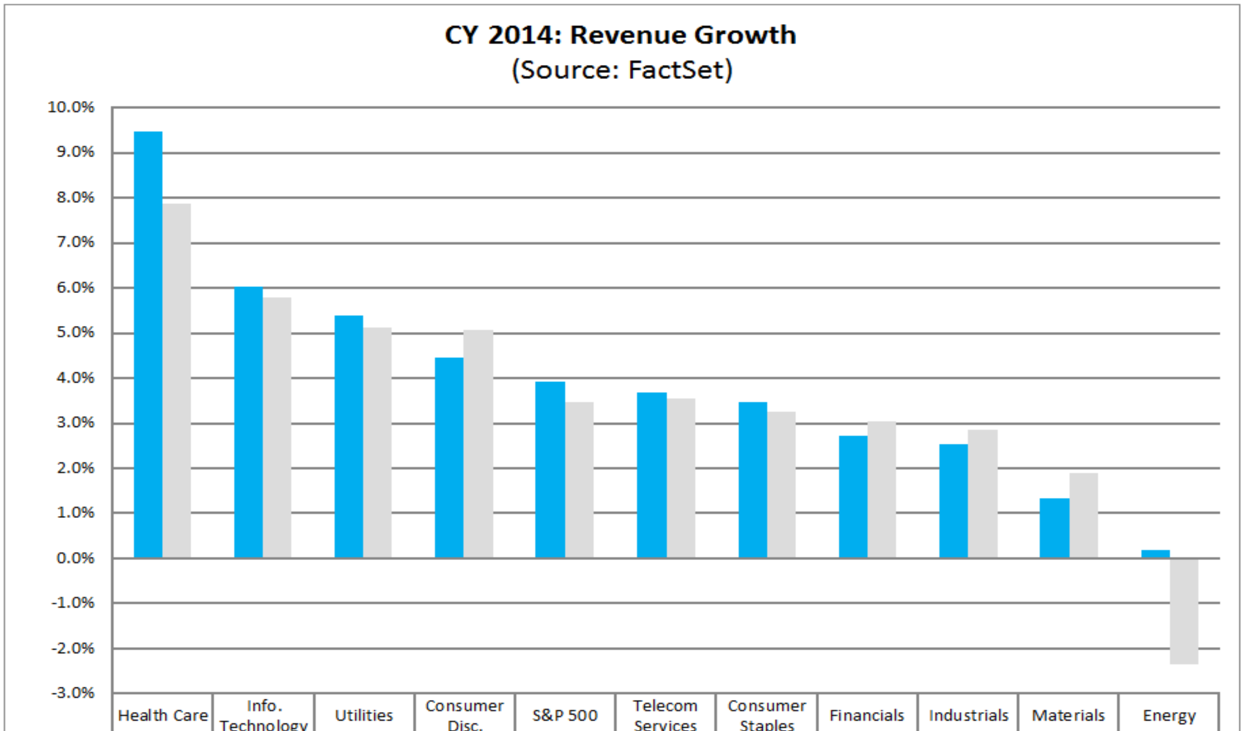


	Health Care	Info. Technology	Utilities	Consumer Disc.	Financials	S&P 500	Telecom Services	Consumer Staples	Industrials	Materials	Energy
Today	10.2%	6.2%	5.2%	4.4%	3.8%	3.7%	3.6%	3.3%	3.1%	1.9%	-2.9%
30-Jun	8.6%	6.3%	5.5%	5.2%	4.5%	3.5%	3.5%	3.4%	3.7%	3.1%	-5.2%

CY 2014: Growth

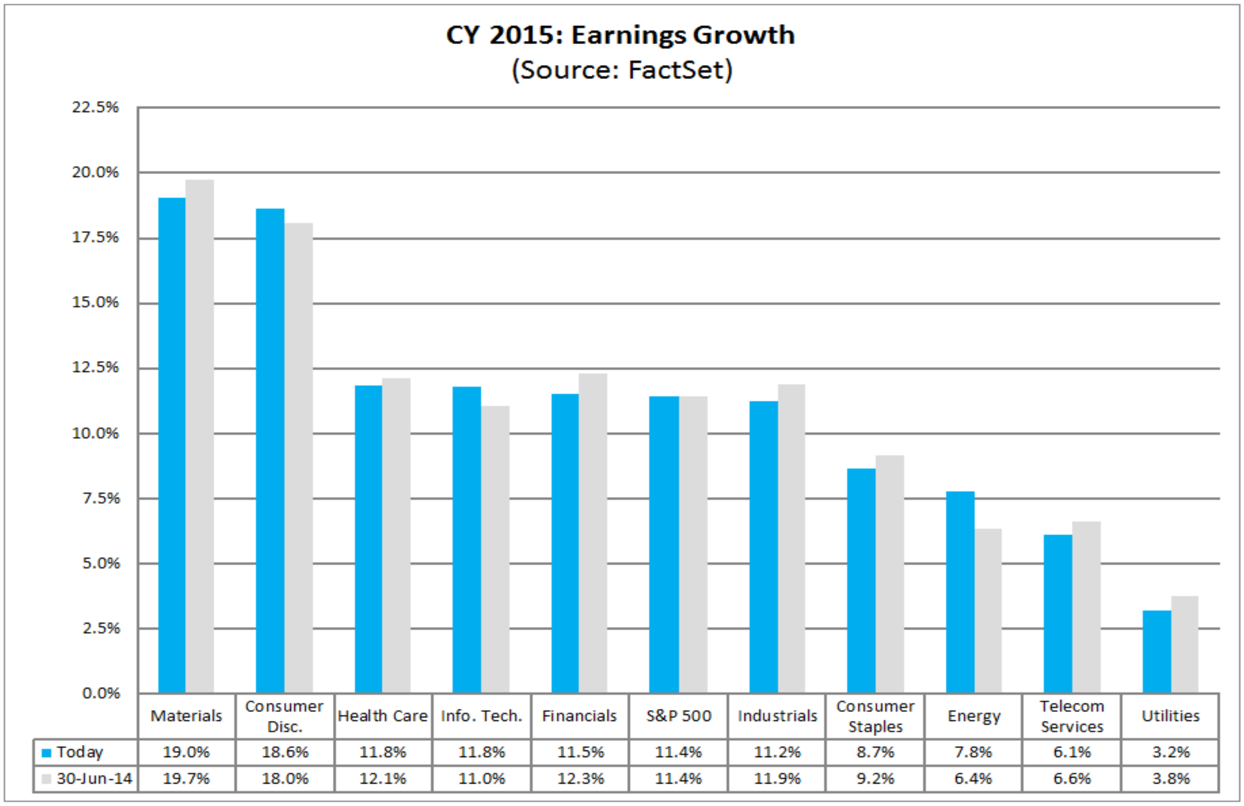


	Telecom Services	Health Care	Industrials	S&P 500	Financials	Energy	Materials	Consumer Disc.	Info. Technology	Utilities	Consumer Staples
Today	29.4%	13.9%	7.5%	7.3%	7.1%	6.2%	5.7%	5.3%	5.3%	4.1%	3.4%
30-Jun	29.9%	10.6%	6.9%	7.1%	6.2%	8.3%	4.7%	7.2%	5.1%	3.9%	4.1%

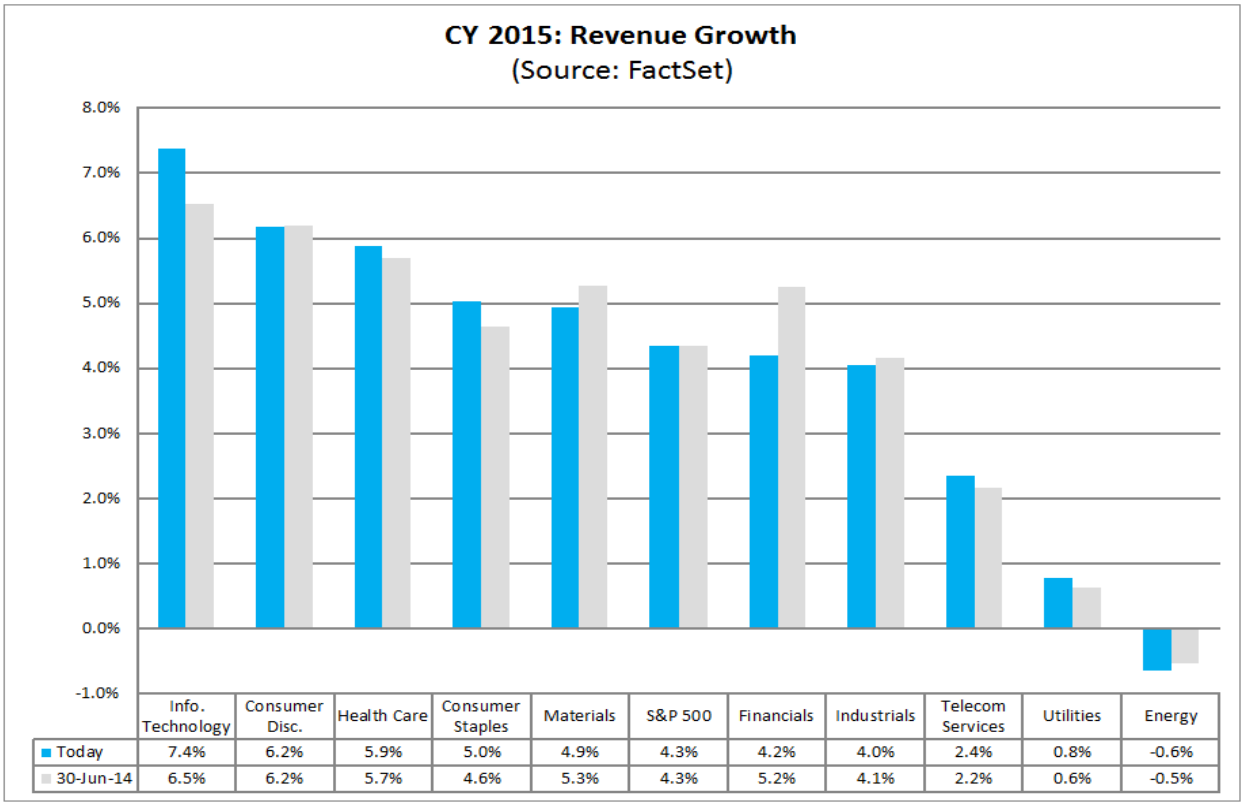


	Health Care	Info. Technology	Utilities	Consumer Disc.	S&P 500	Telecom Services	Consumer Staples	Financials	Industrials	Materials	Energy
Today	9.5%	6.0%	5.4%	4.4%	3.9%	3.7%	3.5%	2.7%	2.5%	1.4%	0.2%
30-Jun	7.9%	5.8%	5.1%	5.1%	3.5%	3.5%	3.2%	3.0%	2.8%	1.9%	-2.4%

CY 2015: Growth

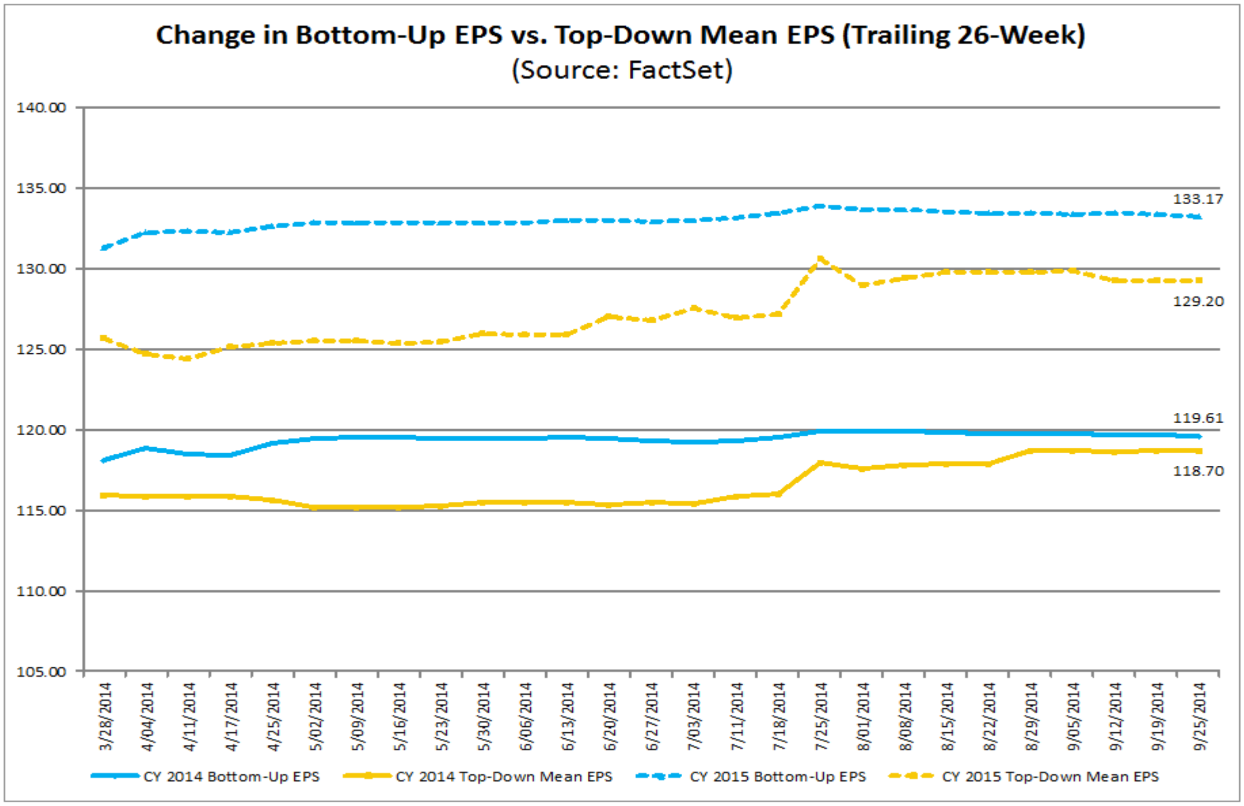


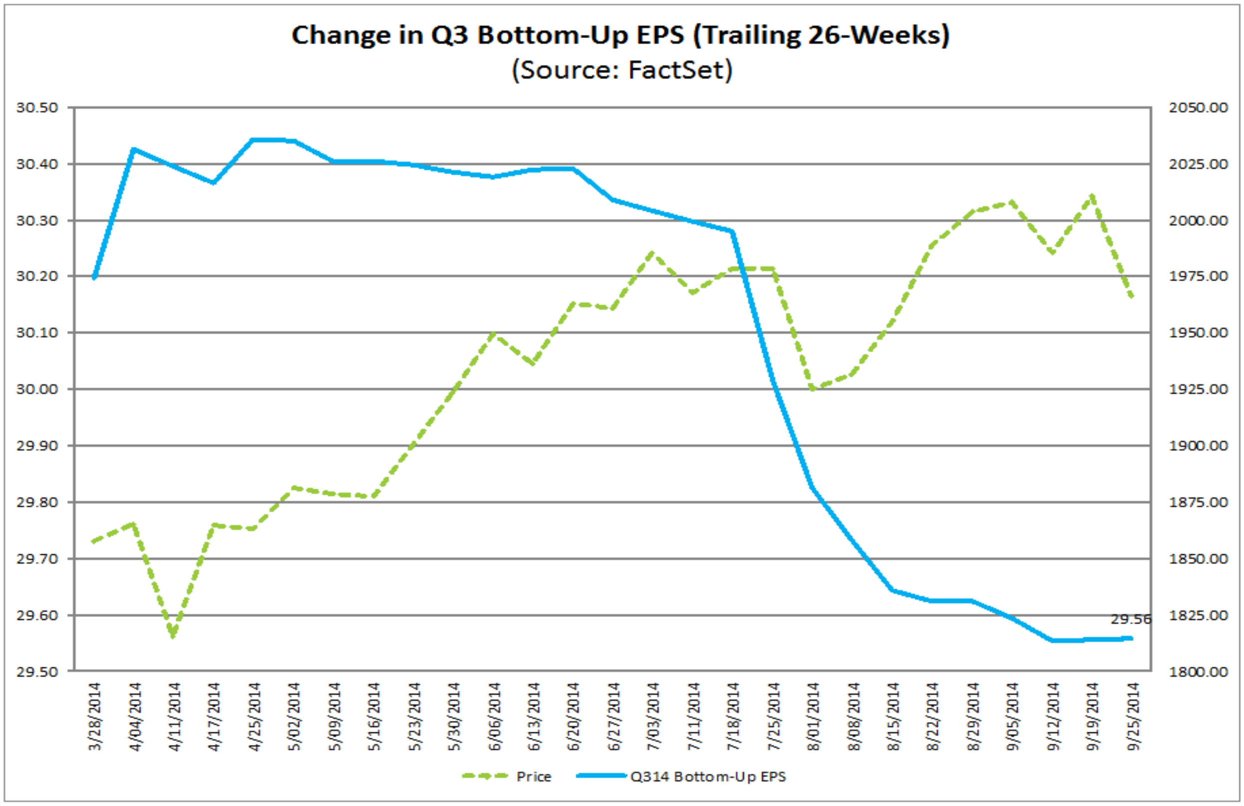
	Materials	Consumer Disc.	Health Care	Info. Tech.	Financials	S&P 500	Industrials	Consumer Staples	Energy	Telecom Services	Utilities
Today	19.0%	18.6%	11.8%	11.8%	11.5%	11.4%	11.2%	8.7%	7.8%	6.1%	3.2%
30-Jun-14	19.7%	18.0%	12.1%	11.0%	12.3%	11.4%	11.9%	9.2%	6.4%	6.6%	3.8%



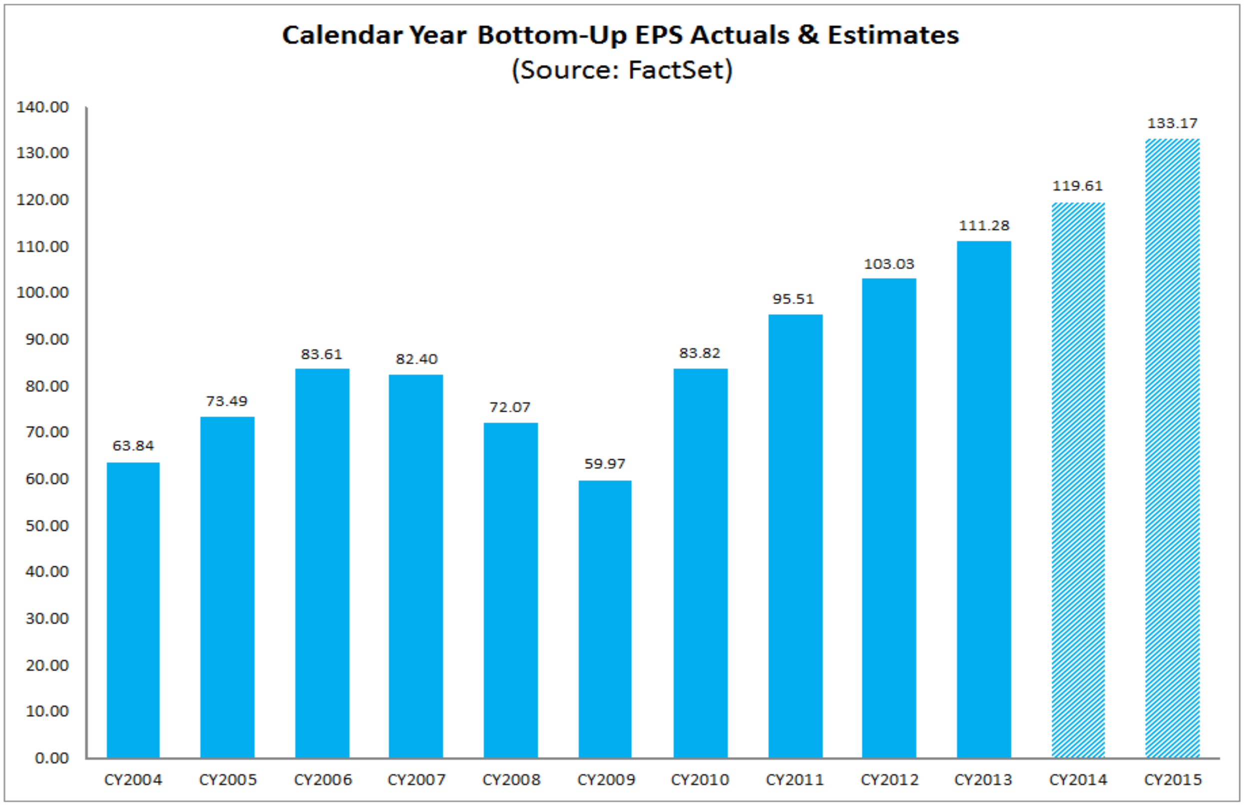
	Info. Technology	Consumer Disc.	Health Care	Consumer Staples	Materials	S&P 500	Financials	Industrials	Telecom Services	Utilities	Energy
Today	7.4%	6.2%	5.9%	5.0%	4.9%	4.3%	4.2%	4.0%	2.4%	0.8%	-0.6%
30-Jun-14	6.5%	6.2%	5.7%	4.6%	5.3%	4.3%	5.2%	4.1%	2.2%	0.6%	-0.5%

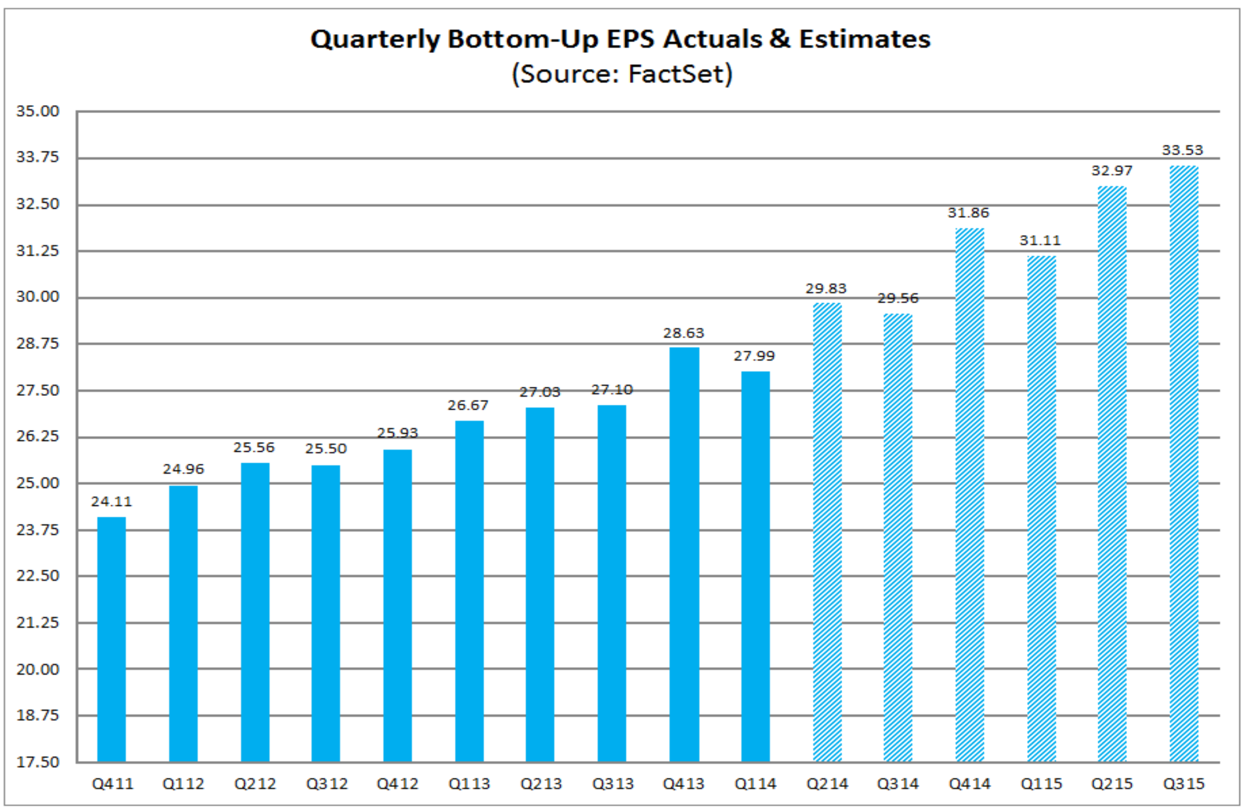
Bottom-up EPS Estimates: Revisions



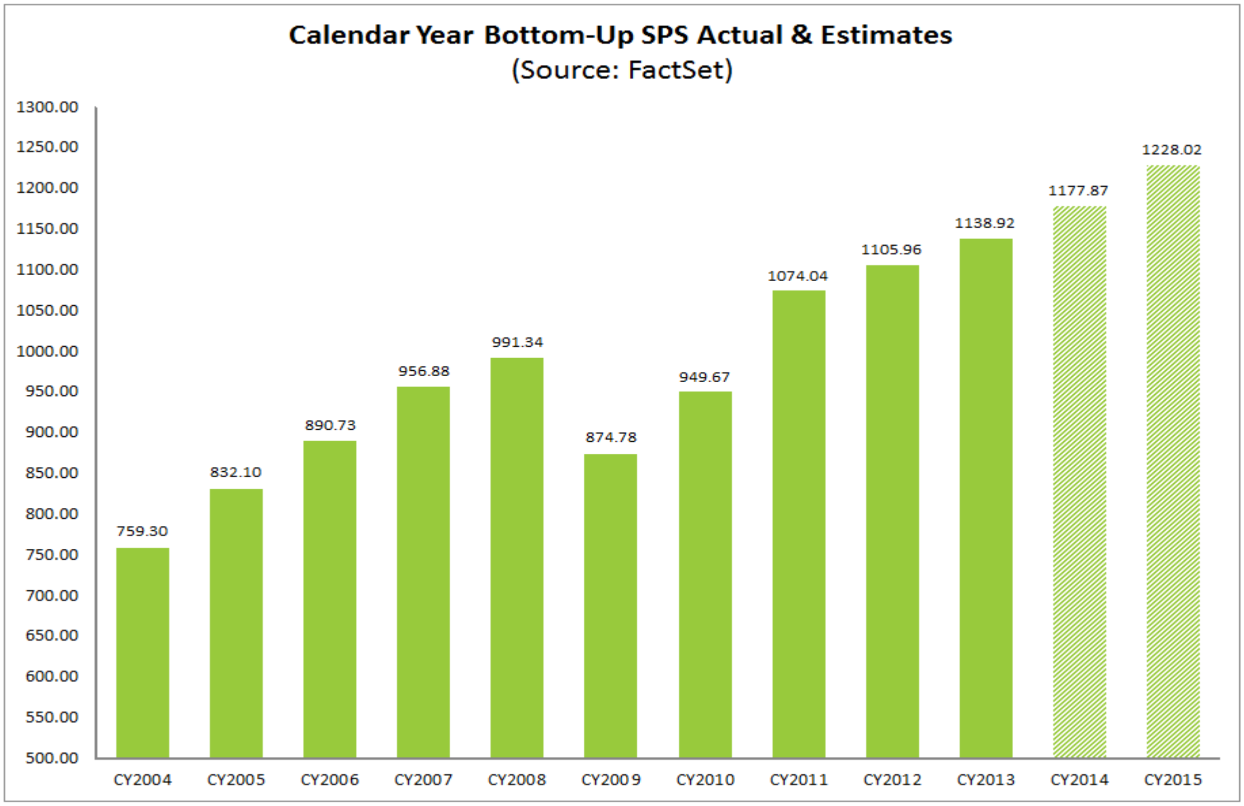


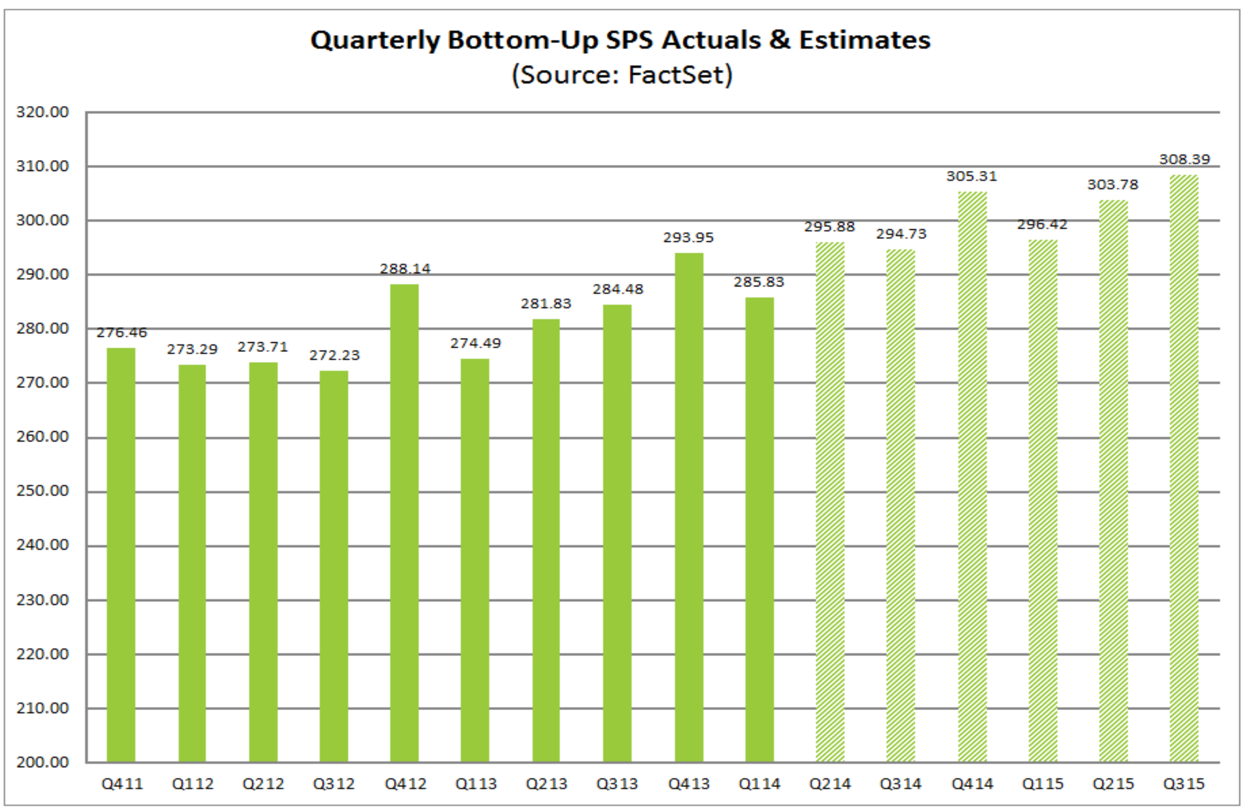
Bottom-up EPS Estimates: Current & Historical



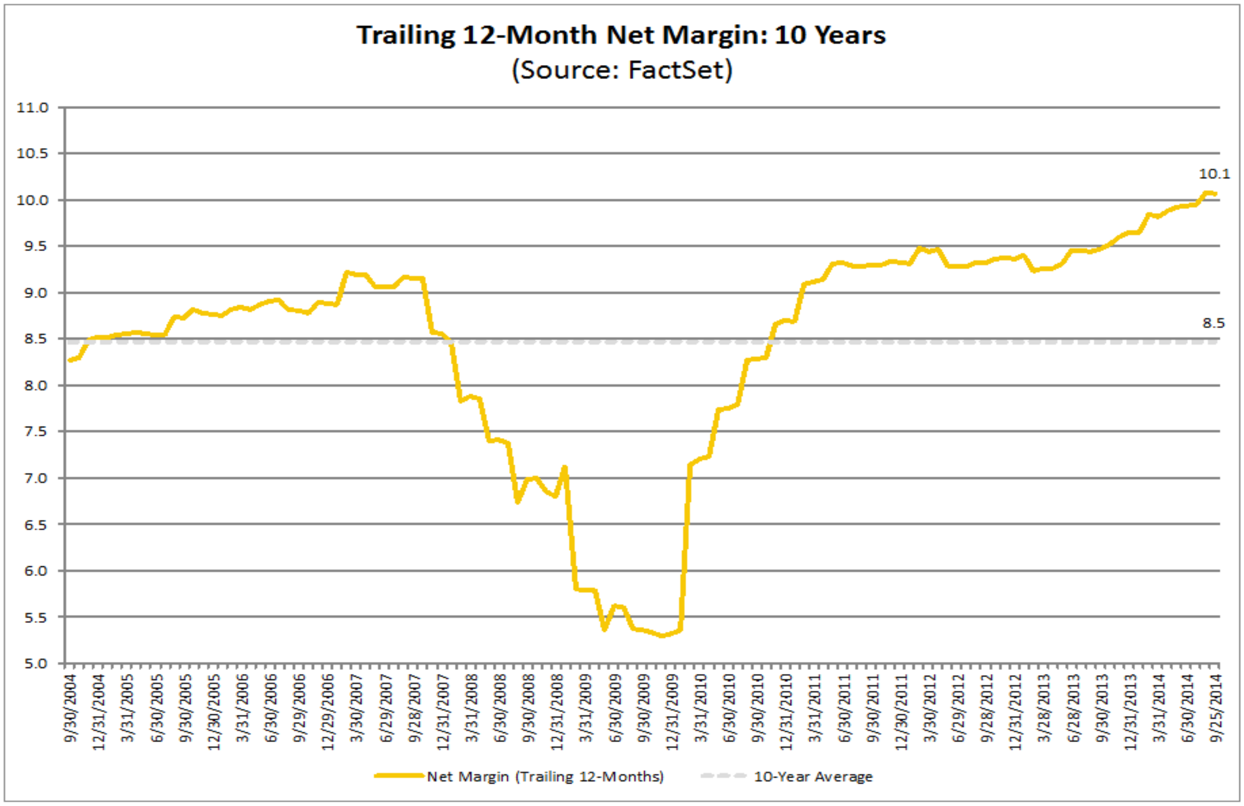


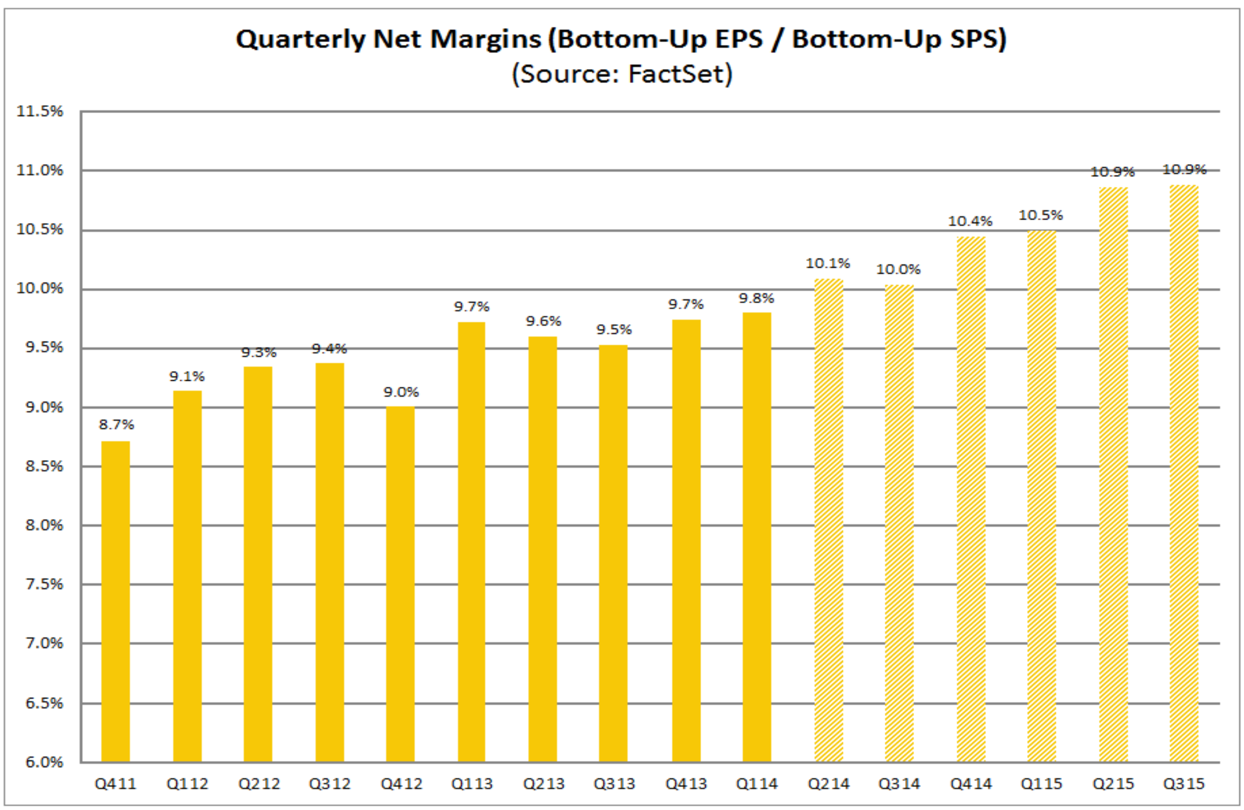
Bottom-up SPS Estimates: Current & Historical



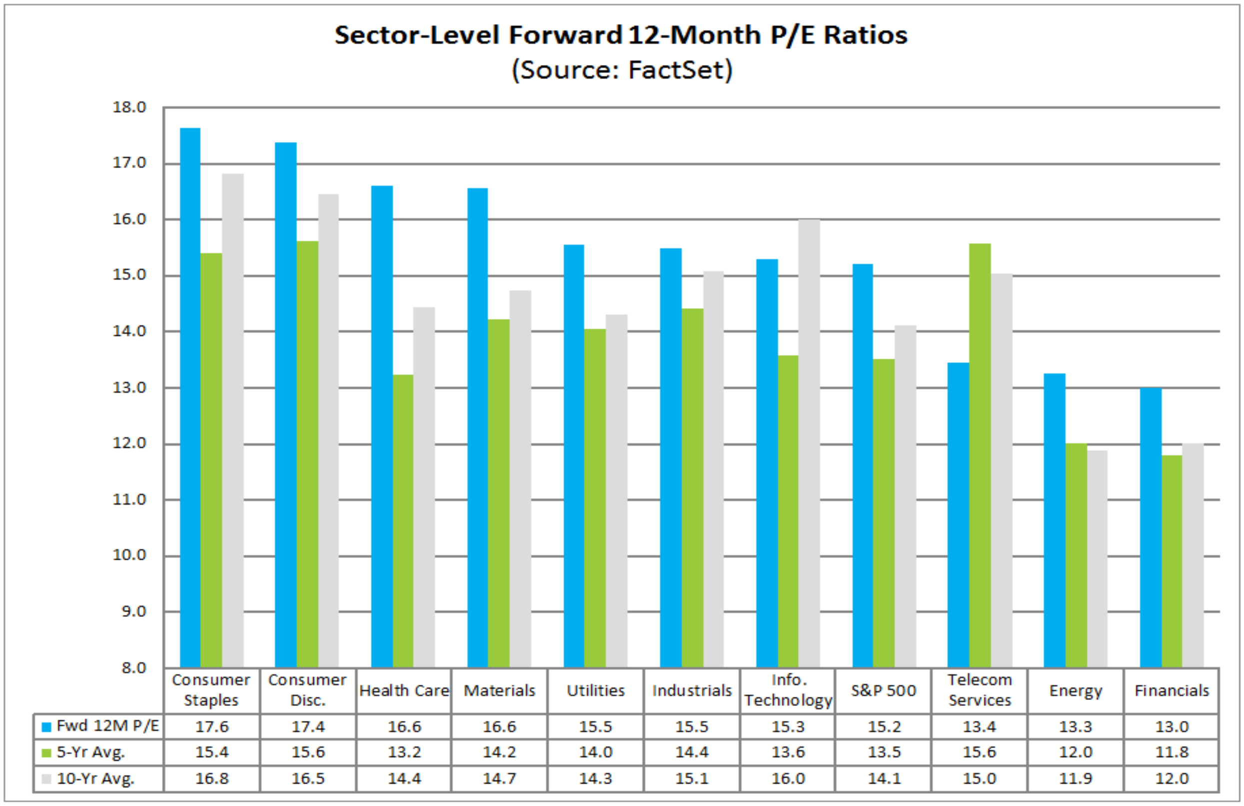


Net Margins: Current & Historical

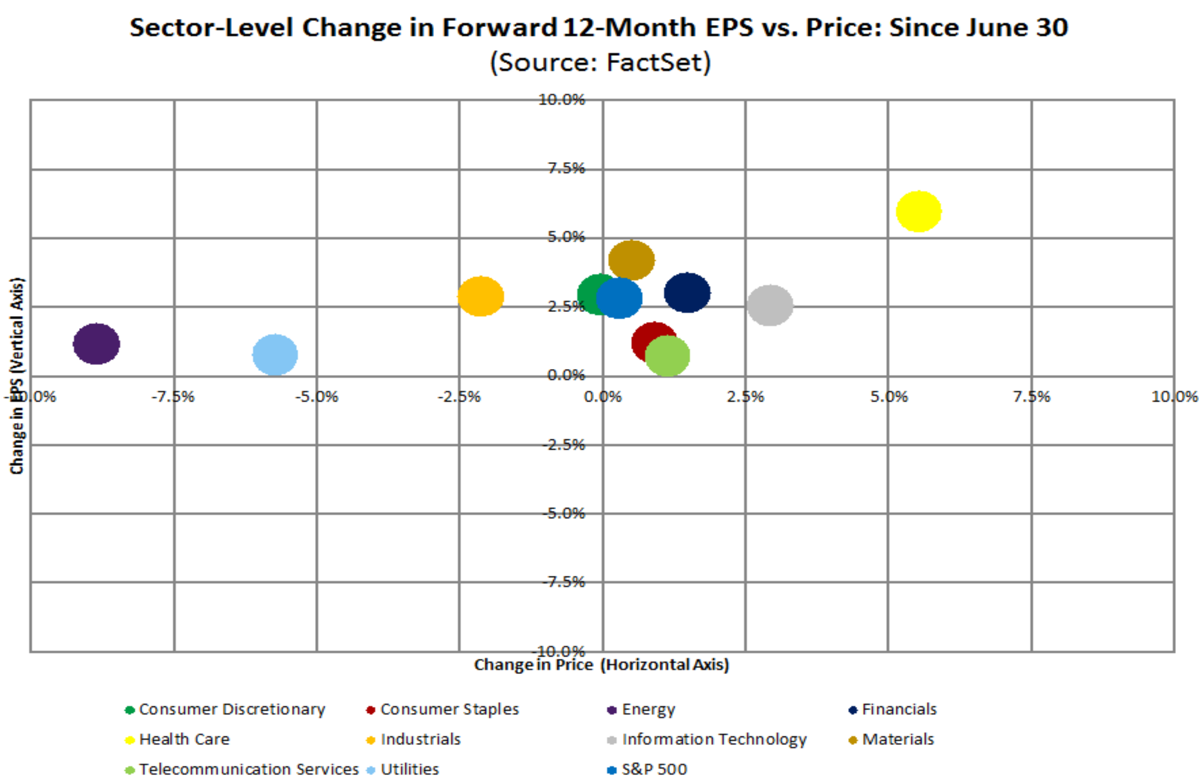




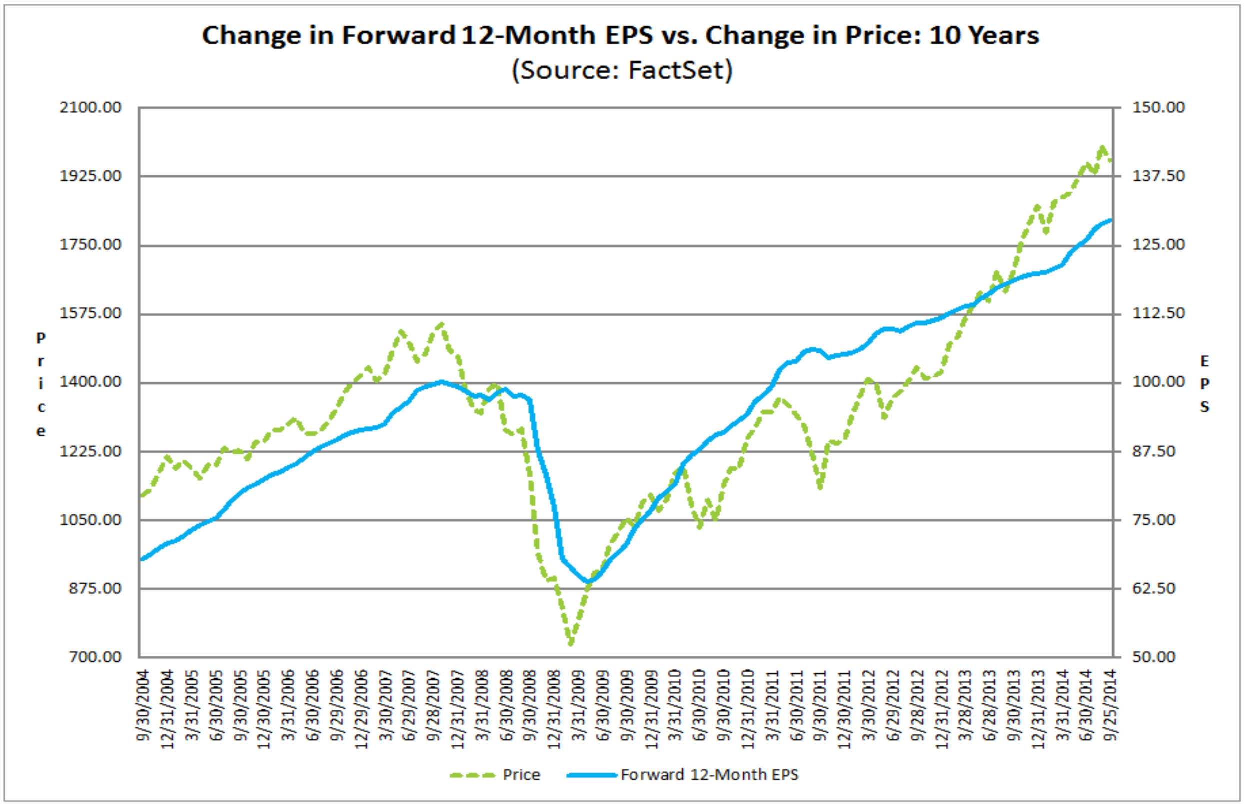
Forward 12M Price / Earnings Ratio: Sector Level

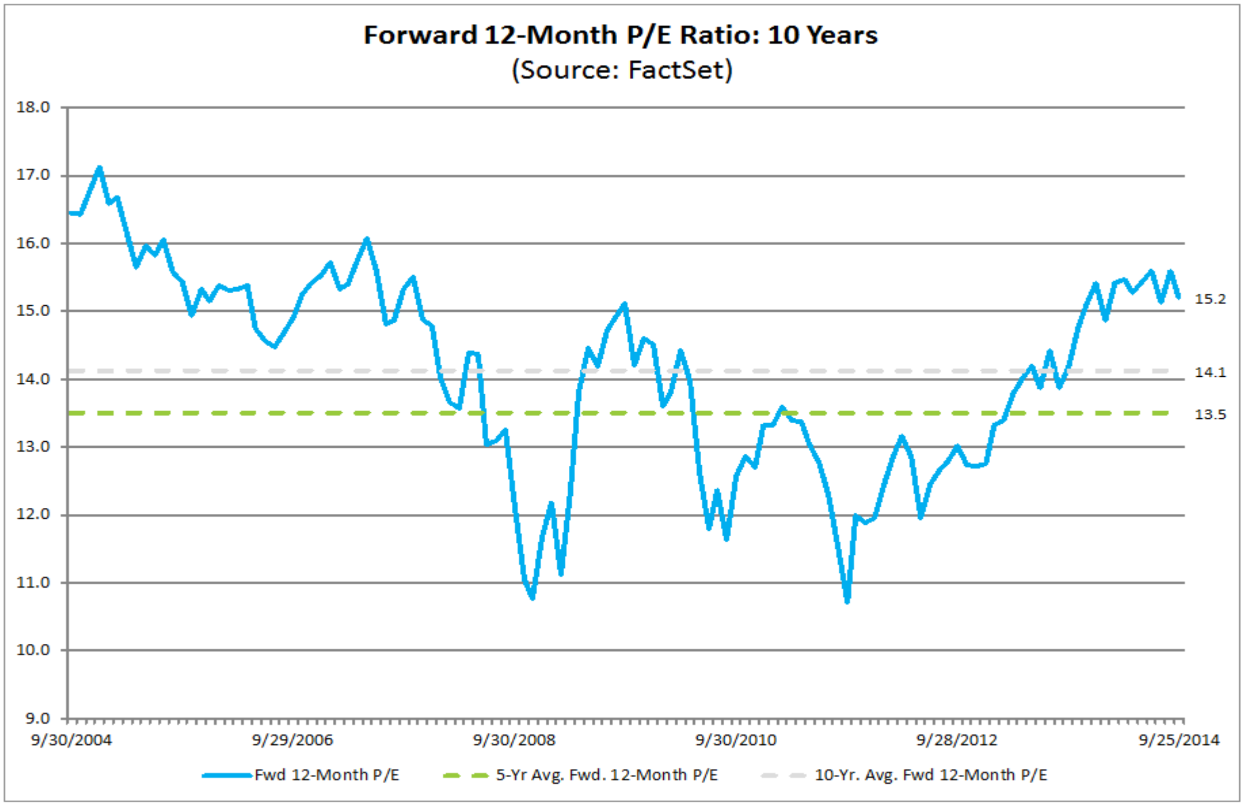


	Consumer Staples	Consumer Disc.	Health Care	Materials	Utilities	Industrials	Info. Technology	S&P 500	Telecom Services	Energy	Financials
Fwd 12M P/E	17.6	17.4	16.6	16.6	15.5	15.5	15.3	15.2	13.4	13.3	13.0
5-Yr Avg.	15.4	15.6	13.2	14.2	14.0	14.4	13.6	13.5	15.6	12.0	11.8
10-Yr Avg.	16.8	16.5	14.4	14.7	14.3	15.1	16.0	14.1	15.0	11.9	12.0

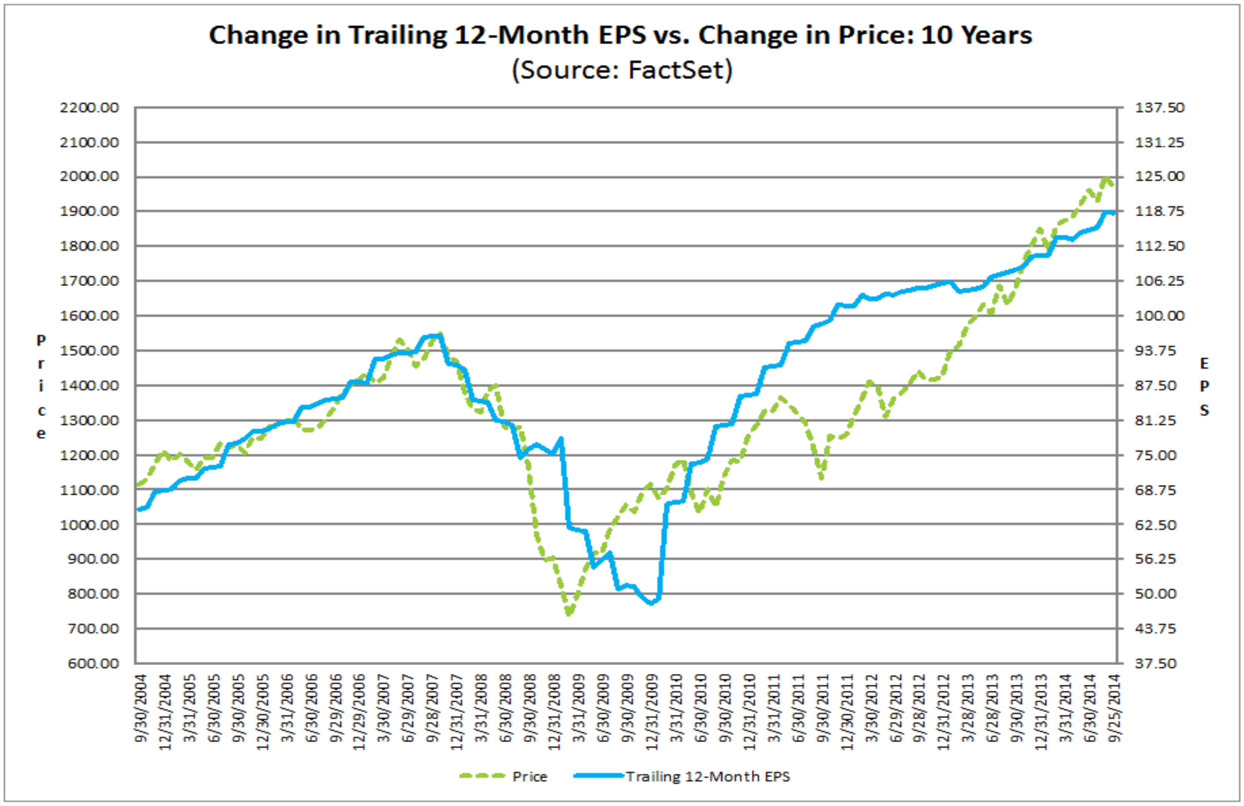


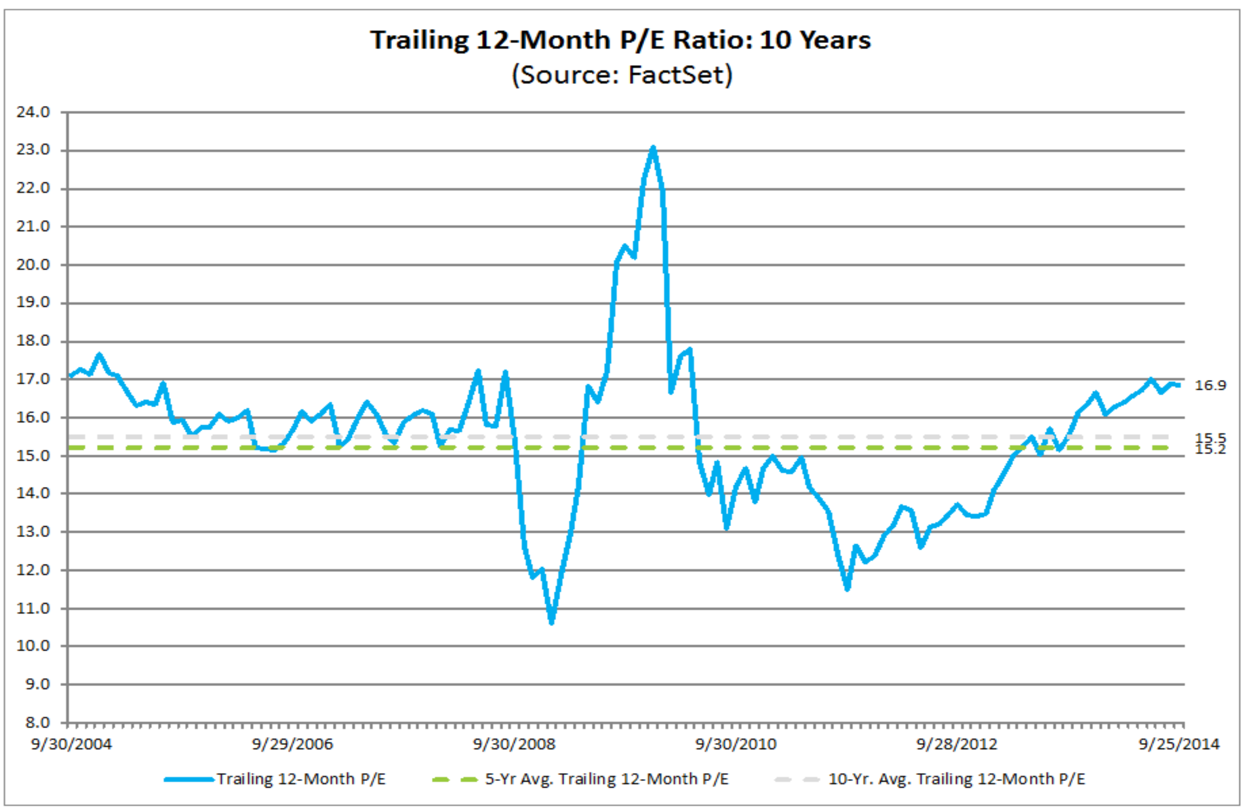
Forward 12M Price / Earnings Ratio: Long-Term Averages





Trailing 12M Price / Earnings Ratio: Long-Term Averages





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