

With Earnings Looming,  
Oil Prices Are in the Spotlight  
March 20, 2004 11:49 a.m.

Rich oil prices promise to create surprises during the first-quarter earnings season – creating opportunities for investors.

Oil prices hit a 13-year high this week amid tight supplies and ongoing trouble in the Middle East. Joe Cooper, senior research analyst at Thomson First Call, says analysts fell miserably short in their forecasts for oil prices this quarter. That means profit estimates may be skewed. Some sectors, like energy, could report better-than-expected earnings, while others, like airlines, could fall short.

Analysts made first-quarter estimates assuming oil prices of about \$31.40 a barrel in the first quarter, Mr. Cooper says; crude oil closed above \$38 a barrel last week, the highest level since 1990. "Analysts tend to chronically underestimate the price of oil embedded in their forecasts," Mr. Cooper says.

So far the market and the economy have held up all right despite soaring oil prices, thanks in part to tax cuts and lower interest rates. The fear is that oil prices may remain rich throughout the second half of 2004, when the effects of the stimulus may wear off. Analysts have been scrambling to adjust earnings estimates so investors won't be caught off guard when earnings start rolling in.

"The market's been able to adjust," says Steve Young, chief investment strategist at Banc of America Capital Management. "It's not something that will surprise everyone [in the first quarter], but it's a growing problem as the counter-balancing stimulus wear off." Here's a look at how the higher oil prices may affect some sectors.

## **Airlines**

Airlines are an obvious victim. Sam Buttrick, airline analyst with UBS Investment Research, wrote in a research note March 18 that the prospects for a recovery in the airline industry are "fading fast," thanks to weaker revenue and high fuel prices. He recently cut his industry estimates for full-year 2004 to a loss of \$2.3 billion from a loss of \$500 million.

Airlines can hedge against higher fuel costs. But last year, most carriers didn't extend hedges because they thought oil prices would fall – something many investors have been wrongfully assuming since the U.S. went to war in Iraq last year.

[Delta Air Lines](#) shares took a 12% hit on Monday after the company said high fuel expenses and weak revenue would cause a wider-than-expected loss for the first quarter. Delta wasn't alone. The American Stock Exchange Airlines index sank 7.9% for the week.

If you want to try your hand at notoriously volatile and often-underperforming airline stocks, recent attention on terrorism and oil prices has beaten down some shares to the point where analysts say they are undervalued.

Daniel Hemme, an analyst for Prudential Equity Group, this week said American Airlines parent [AMR](#) is an "attractive investment" at current prices and put a \$20 price target on the stock, which closed Friday at \$11.38.