

Katrina May Cut Profit at Ailing Airlines, Automakers (Update1)

Sept. 1 (Bloomberg) -- Before Hurricane Katrina slammed into the Gulf Coast this week, crippling petroleum production, record-high energy prices had already started to squeeze earnings at U.S. companies such as Wal-Mart Stores Inc.

Now the outlook has suddenly grown worse for many corporations -- from Wal-Mart, the world's biggest retailer, to insolvent airlines like United Airlines Inc. and money-losing automakers such as General Motors Corp.

"The last week has opened up a Pandora's Box," says Christopher Johnson, 37, an analyst at Schaeffer's Investment Research, an equity research firm in Cincinnati. "The impact of higher oil prices will be widespread. Corporate earnings were already going to be stressed in the second half."

That was evident today as retailers such as Wal-Mart and carmakers including General Motors and Ford Motor Co. reported weaker-than-forecast sales for August.

Oil and gas prices jumped to new records this week after the scale of Katrina's devastation became clear. Damage to drilling rigs and pipelines in the Gulf Coast region, which produces one-third of the oil and a fifth of the natural gas in the U.S., raised concern about shortages.

Gasoline futures soared for a fourth day today, and at many filling stations prices at the pump shot above \$3 a gallon overnight. Gasoline prices have more than doubled in a year.

That's bad news for Detroit carmakers counting on sales of gas-hungry trucks and sport-utility vehicles for a recovery.

GM Sales Fall

General Motors, which lost \$3.3 billion in North America in the first half of the year, said today its August U.S. sales fell 13 percent. Ford's sales rose 6.3 percent, less than analysts expected, with its biggest SUVs down 40 percent. The 5.1 percent gain for DaimlerChrysler AG's Chrysler trailed estimates as well.

High gas prices had already begun hurting sales at Detroit-based GM, the world's largest carmaker, before today's sales report. Moody's Investors Service last week joined Fitch Ratings and Standard & Poor's in reducing GM's credit rating to high-risk, high-yield junk. The three rating companies are based in New York.

Sales at U.S. retailers including Wal-Mart and Federated Department Stores Inc. rose 3.6 percent in August, less than forecast, as the rising energy prices trimmed consumer spending on fall clothing and school supplies. Wal-Mart had a 3.3 percent increase, its worst gain since May.

The International Council of Shopping Centers said sales this month will climb as little as 3 percent, the smallest gain in four months.

Major U.S. airlines, which have had four consecutive years of losses, also received a stiff jolt from Katrina as the soaring price of crude pushed up already record-high jet fuel prices.

"Hanging by Fingernails"

`` The airline industry is hanging by the tips of their fingernails," says Fadel Gheit, senior vice president of Oppenheimer & Co., a New York-based investment firm.

Earnings growth for companies in the Standard & Poor's 500 Index may drop below 10 percent in the fourth quarter compared with that quarter last year, says Howard Silverblatt, an analyst for New York-based Standard & Poor's Corp.

That would be the smallest rise in more than three years. The index's gains have slowed from 30 percent in the fourth quarter of 2003 as oil prices have surged.

The third-quarter gain for the benchmark index won't reach 15 percent, the current average estimate of analysts polled by Thomson Financial, even though the quarter is two-thirds over, says Silverblatt, 51.

Katrina struck the Gulf Coast states of Louisiana, Alabama, Mississippi and Florida on Aug. 29, causing what insurers estimate could be \$25 billion of damage. That would make it the costliest natural disaster in U.S. history.

` Years' for Recovery

New Orleans Mayor Ray Nagin said yesterday the hurricane probably killed hundreds and `` most likely thousands" of residents.

`` This recovery will take years," said President George W. Bush.

Katrina shut 95 percent of Gulf Coast crude-oil production and 88 percent of its natural gas output. Eight refineries in Louisiana and Mississippi, accounting for more than 10 percent of U.S. refining capacity, were closed. The region receives more than half of U.S. oil imports and is home to about 50 percent of the nation's refining.

Crude oil for October delivery rose 53 cents, or 0.8 percent, to \$69.47 a barrel in New York. The contract touched \$70.85 on Aug. 30, the highest since futures trading began in 1983. Prices are 58 percent higher than a year ago.

Energy Users Suffer

`` This is hurting companies that are heavy users of energy, such as airlines, trucking companies and cruise lines," says Franklin Morton, research director for Chicago-based Ariel Capital Management with \$20 billion in assets. `` Anyone who uses plastic in products or packaging has higher costs."

Gasoline for October delivery surged 15.37 cents, or 6.8 percent, to close at \$2.409 a gallon on the New York Mercantile Exchange. The October contract has risen 28 percent this week. The September gasoline contract touched \$2.92 a gallon yesterday, the last day it traded, the highest since trading began in 1984.

`` Now we are on levels which, even adjusted for inflation, are basically at the high we had in the 1980s," says Dieter Zetsche, Chrysler's outgoing chief executive officer and DaimlerChrysler AG board of management member.

Jet fuel, which is refined from crude oil, has risen 21 percent to \$2.32 a gallon in New York since Aug. 26, the last day of trading before Katrina swept through the Gulf Coast. Fuel is the second-biggest cost for most carriers, after labor.

` Little Value' in Airlines

`` We see little value in the broader airline sector against surging crude prices," Jamie Baker, a New York-based analyst with J.P. Morgan Securities Inc., said in a report yesterday. He said analysts may soon reduce their estimates for airlines' financial results.

Atlanta-based Delta Air Lines Inc. and St. Paul, Minnesota- based Northwest Airlines Corp., the No. 3

and No. 4 U.S. carriers, have repeatedly warned this year that they may be forced to seek bankruptcy protection to reduce costs and stem losses. Northwest is being struck by its mechanics union.

`` All of these shocks sure don't help anything," says Tim Wagner, spokesman of Fort Worth, Texas-based AMR Corp.'s American Airlines.

Businesses Cut Spending

High oil prices are also prompting some businesses to postpone orders for capital equipment, according to a survey of 374 chief financial officers by Duke University in Durham, North Carolina.

While two-thirds of the CFOs said they planned to increase capital spending on plant and equipment, the average 4.7 percent increase was cut from 5.4 percent six months ago.

The spending is "barely sufficient to replace depreciated assets," says Duke finance professor Campbell Harvey.

Among the businesses most directly hurt by Katrina were casinos built along the Mississippi coast. Harrah's Entertainment Inc., the world's largest casino company, said its riverboat Grand Casino in Biloxi was likely completely destroyed. Its Grand Casino Gulfport also suffered `` extensive" damage.

`` Our Biloxi casino was separated from its moorings and taken literally across the street and plopped down about a block or so away from where it normally sits," Chief Executive Officer Gary Loveman says.

The hurricane is expected to cut Las Vegas-based Harrah's earnings 5 cents to 10 cents over the next two to four quarters, KeyBanc Capital Markets analyst Dennis Forst wrote in a report yesterday. He has an `` aggressive" buy rating on the stock.

Dow Chemical

Dow Chemical Co. of Midland, Michigan, and Los Angeles-based Occidental Petroleum Corp. are among at least 10 chemical makers that cut output from plants in Gulf Coast states lashed by Katrina's winds and flooding.

Dow, the top U.S. chemical manufacturer, idled a plastics plant in St. Charles, spokesman Chris Huntley said. Dow continues to operate its ethylene plant in Plaquemine, Louisiana, while some related operations that use ethylene as a raw material are closed.

The shutdowns will reduce Dow's third-quarter earnings by about 5 cents a share to 91 cents, JPMorgan analyst Jeffrey Zekauskas estimated yesterday.

' Short-Term Spiking'

`` I expect there to be short-term spiking of prices" for plastic resin, says Gene Pisasale, senior research analyst at Wilmington Trust Corp., the sixth-largest holder of DuPont Co. stocks with 21 million shares. That could cut sales, he says.

The higher costs will hurt manufacturers such as Clorox Co. of Oakland, California, which uses plastic in its Glad Bags and in bleach bottles, and Cincinnati-based Procter & Gamble Co., which uses plastic in detergent bottles, says Morton, whose firm is the sixth-biggest holder of Clorox shares.

`` Anyone who uses plastic in products or packaging has higher costs," he said. `` There is a lag in the ability of companies to raise prices, and that is affecting margins."

Consumers had begun to reduce purchases at Bentonville, Arkansas-based Wal-Mart and the restaurants of Overland Park Kansas-based Applebee's International Inc. even before the hurricane, in part because of higher energy costs.

Now, they're likely to trim outlays further because they are spending more at the pump, says Marshal Cohen of NPD Group, a Port Washington, New York, market research firm.

Wal-Mart on Aug. 16 reduced its full-year earnings forecast and said second-quarter profit increased by the smallest amount in four years.

San Francisco-based Gap Inc., the largest U.S. clothing retailer, said today its August sales dropped 9 percent. Chief Financial Officer Byron Pollitt had said during an Aug. 18 conference call the company was concerned how consumers would respond to gas prices in the second half of the year.

Some Winners

Hurricane Katrina will also leave some beneficiaries in its wake, along with the devastation and loss of life.

``The most conspicuous winners are producers in natural gas," says Donald Coxe, global portfolio strategist for Bank of Montreal in Chicago. ``The big story here is the gigantic move in natural gas, and that's here to stay because we're coming into winter."

Burlington Resources Inc. in Houston, EnCana Corp. in Calgary and Devon Energy Corp. in Oklahoma City are among the largest North American gas producers.

The S&P 500 Oil & Gas Exploration and Production Index has risen 5.9 percent over three days.

Atlanta-based Home Depot Inc. and Lowe's Cos. of Mooresville, North Carolina, the two biggest home-renovation retailers, will benefit from demand for rebuilding homes in Mississippi and Louisiana, Merrill Lynch analyst Danielle Fox said in a report Aug. 29.

Home Depot shares have risen 80 cents or 2 percent to \$40.61 over four days. Stock of Lowe's has risen \$1.46 or 2.3 percent to \$64.64.

To contact the reporter on this story:
Steve Matthews in Atlanta at smatthews@bloomberg.net

Last Updated: September 1, 2005 17:25 EDT

 **Print**