Dollar to Play A Central Role In Profit Data

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ABREAST OF THE MARKET

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Quarterly corporate earnings, to be released during the next few weeks, will be even more important than usual to a stock market looking for clues about how fast the economy is slowing down.

But first, investors are going to have to separate the wheat from the chaff. The chaff in this case is the dollar, which this year has gone through convulsions not seen in years. Overall, the Fed's Board of Governors trade-weighted dollar fell nearly 8% in the first quarter.

The story varies significantly, however, depending on which countries a particular company operates in, and the degree to which the company hedges its activities against currency swings.

For example, the dollar is down 17.02% against the Japanese yen, the currency of the second-largest U.S. trading partner. But it is up 18.68% against the Mexican peso, the currency of the third-largest U.S. trading partner. (Canada takes the honors as America's No. 1 trading partner.)

And while the dollar will be a slight positive for **Coca-Cola** during the first quarter, it will be a negative for its carbonated rival **PepsiCo**. While the benefit or damage of the currency swings is equally real for each company, it says nothing about the competitiveness of their marketing or operating plans.

"You have to separate out the effect of the currency and ask yourself: How would the company have done in local currency?" says Terry Bivens, food, tobacco and beverage analyst for Argus Research. "If you see a company that has done badly because of currency translations, but is going strong in local terms, then you're more reassured."

Mr. Bivens has his hands full this quarter, covering companies such as PepsiCo, **CPC International** and **RJR Nabisco Holdings**, consumer-goods companies with extensive sales abroad. Currency volatility, he says, "makes things more compli-

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Dollar's Swing May Hold the Key To Earnings for Many Companies

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cated."

PepsiCo will "take a slight hit to earnings" because of the dollar's appreciation against the peso, Mr. Bivens says. The Purchase, N.Y., soft-drink, snack-foods and restaurant concern concurs, but won't say what the global impact will be until it releases earnings on May 2.

The reduction in the value of the peso not only makes the earnings of Pepsi's Mexican operations less valuable in dollar terms, but it also makes the company's product less competitive by reducing local demand if PepsiCo is forced to raise prices.

Coke says it will record a "slight positive effect on earnings" from currency fluctuations. The Atlanta-based beverage behemoth will report its earnings the day of its next board meeting in April.

CPC International, of Englewood Cliffs, N.J., which produces consumer foods and refined corn products, "should be helped a little bit" by the currency fluctuations, says Jack Maxwell, analyst at Wheat First Butcher Singer.

Sometimes the benefit of a weak dollar will not be reflected in earnings. Mr. Maxwell notes that many companies budget expenditures in dollars, and plow any gains from a falling dollar into extra marketing and hiring rather than let it go straight to the bottom line. To investors he advises: "Read the quarterly reports."

International Business Machines, another multinational giant whose revenue comes largely from abroad, declines to say before April 20 how currency fluctuations will affect its earnings. But IBM Chief Executive Louis Gerstner did say two weeks ago in Japan that he expects the rapid appreciation of the yen to have "a slight positive impact." Most of IBM's international revenue comes from Europe and Japan, with Mexico representing a considerably smaller amount.

A.C. Moore, president of Dunvegan Associates, a money-management firm in Santa Barbara, Calif., says "it is going to be tough" for both analysts and investors to tell what's what in the current crop of earnings reports. "It will be a switch from normal domestic analysis to international analysis," Mr. Moore adds.

Telling how a company will be affected won't just be a matter of figuring how much a company sells in which country. That in itself can be difficult enough, as many companies report revenue and earnings by region, not by country. But complicating matters further is the fact that companies often try to hedge much of their currency risk. They don't hedge all risk, however. "Hedging is expensive," says Mr. Moore.

Earnings are increasingly important for investors to parse out this year because the Federal Reserve appears near the end of its year-long series of interest-rate increases, especially if the economy slows down as expected. In 1994, while the Fed was busy jacking up rates six times, stock prices remained flat even though earnings were growing.

"Earnings and interest rates are the keys, and interest rates are not the drivers this quarter, earnings are," says Mr. Moore.

Already, a few companies have suffered the wrath of investors because they will not meet first-quarter earnings expectations. **Wall Data**, a networking software developer, fell 19¾, or 48%, to 22 earlier this month after reporting that it wouldn't meet first-quarter earnings expectations. It closed Thursday at 20¾. Sybase plunged 41% soon after saying its first-quarter earnings would also be lower.

Like interest rates, another factor that may be less important this year is corporate restructuring and cost-cutting, which helped earnings ratios during the past few years but seems to be about played out. So much "fat" was cut out that some analysts say there may not be more to slice.

"What you saw in '94 a lot was the benefit of restructuring," says Melissa R. Brown, director of quantitative research at Prudential Securities. "I don't see that you're going to have that type of explosion. It's going to diminish."