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The Railroad Week in Review 6/30/2001

Nasdaq short interest was posted this week in the WSJ and the only railroad listed was RAIL with a 69% increase to 912,160 shares, up from 538,593 for the month. Put in context, average daily volume is 260,000 shares. The short interest is the number of average trading days to cover the shares short, ergo RAIL has seen a bump to 3.5 days from 2.1 days.

GNWR, not in the paper, can be found nonetheless at www.shortinterest.com and for the month short shares rose to 8,400 from 5,200, up 61%. Average daily volume is 13,000 shares so the short interest rose to 1.5 days from 2.5 days. Recall that an increase in short interest can sometimes be taken as a sign of weakness in a stock. Of course, the clever investor always checks the fundamentals before making a move long *or* short.

Fallout continues from last week's STB merger ruling. John Snow of CSX told the senate hearing that "CSX has absolutely no plan, intentions, or inclinations" for any rail mergers. While commending the STB for its "timely, open, professional and fair" decision, Snow added that the rulemaking "tells me that future Class One rail mergers will be much harder to accomplish, which is as it should be given the industry's recent history and current circumstances."

More important, Snow reaffirmed that CSX would be opposed to any mergers initiated by anyone else as well until merger-related problems are much more a thing of the past. He concluded, "As I see it, there is little or no sentiment for additional major mergers among the rails themselves, from our customers, or from our investors. The challenge is to develop and test ways to reap many of the benefits of consolidations without precipitously plunging down the merger track."

Markets yawned Wednesday following the Fed's quarter-point rate cut only to respond more positively on Thursday. The Wednesday consensus seemed to be that consumer spending hasn't slowed much despite all. If the rate cuts start to have their desired effect by next year, the economic uptick could start to show up in stock prices this fall -- further validation of the 2H01 scenario we've been hearing about.

Friday's "Abreast of the Market" in the WSJ noted that declines in petroleum products prices sparked a sell-off in energy stocks but helped the rails. Crude oil is in the lower end of the expected OPEC target range of $22-$28 per barrel. Dec heating oil (a proxy for diesel) closed at 74 cents a gallon, down from 84 cents yoy.

In the meantime, the trucking industry is having some troubles of its own. Daimler's Freightliner unit will be laying off another thousand souls as production has dipped to 425 cabs a day from 500. Plants in North Carolina, Mexico and Canada are affected. It is anticipated the division will report an operating loss for year of some $400 mm. In a related development truck component maker Eaton Corp expects earnings as much as 30% below already diminished expectations thanks in part to the soft North American market for its products.

Truck operators are hit, too. Monday's WSJ carried a feature on the fate of C&B Trucking based in Arkansas. With rising fuel costs, higher insurance rates, and intense competition more than

1,200 companies called it quits in Q1 alone while 3,600 small trucking firms packed it in last year.

Even worse, it's a buyers' market for used equipment. Used cabs are going for $35,000 where they once sold new for three times that. Last year's failures alone pumped 155,000 used cabs onto the market, creating a further drag on the prospects of OEMs like Freightliner and Eaton. Is it possible the rails are finally going to grab something more than a 7% share of the intercity freight market?

RailAmerica figures more than 15,000 miles of North American railroad will be on the block in the near future with class 1s and existing shortlines the sellers. Overseas, RAIL has its eye on some 20 upcoming privatizations. An integral part of the Company's 2001 plan includes completing its rolling stock sale and leaseback program, raising new equity and the rationalization of non-strategic assets.

Accordingly on Friday RAIL announced the sale of 3.8 mm shares for $41 mm. The transaction provides additional capital to finance rail acquisitions, de-lever the balance sheet and reduce the cost of debt. Most important, it also allows RAIL to get closer to achieving its previously stated year-end 2001 debt-to-equity ratio target of less than 2:1.

GATX (NYSE: GMT) is one of those under-appreciated unsung railroad-related companies that not only holds its own against the GEs of the world but also attracts the attention of Warren Buffett's Berkshire Hathaway, a 15% stakeholder. This week's Barron's notes that "GATX is one of the largest lessors of railroad cars, along with GE and Union Tank Car, a private company controlled by the Pritzker family. GATX's specialty is tank cars that hold chemicals and other products. GATX is No. 3 globally in aircraft leasing behind American International Group and GE. The company also leases technology equipment and makes tech venture capital investments."

That would seem to some a mixed blessing as rail usage has come under pressure not only from the economic softness but also improved equipment utilization on the part of the railroads themselves. Even at that the Street estimates $3.75 a share this year and $5.00 a share next. At Friday's close of $40 GMT sells for ten times earnings and a PEG ratio (PE/growth rate) of 0.3, clearly in the range to be worth a second look.

Concludes Barrons, "GATX conceivably could become a takeover target for Berkshire or AIG because GATX sees a great opportunity to expand its railcar leasing operations overseas where formerly government-owned railroads are being privatized. That expansion probably will require more capital, which might prompt management to look for a merger partner. Buffett has made some investment mistakes in the past year, including the purchase of a stake in USG, but the Great One usually doesn't err too often, especially in businesses like leasing that he knows well."

Roy Blanchard

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