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The Railroad Week in Review 9/2/2001

August was unkind to the stock market, sending the Dow down 5%. The rails as a group drifted sideways such that the 50-day moving averages of all but Genesee & Wyoming (GNWR) and Canadian National (CNI) turned negative. Moreover, only those two plus RailAmerica (RAIL) ended the month trading above the 50-day average.

The rail supply crowd could hardly be expected to do any better, and they didn't. For the month, only Trinity Industries (TRN) saw any increase, getting a slight bump the 13th on the Thrall acquisition announcement, then drifting lower. Wabtec (NYSE: WAB) is the sole survivor above the 50-day curve. For the record, our vendor market basket now includes ABC-NACO (Nasdaq: ABCR), GATX (NYSE: GMT) Greenbrier (NYSE: GBX), Railworks (Nasdaq: RWKS), TRN, and WAB.

TRN was featured in a recent WSJ On-Line piece, "In this market you need to think small." The argument is that small cap players in low-tech industries, and transportation is one of them. Says the paper, "This sector is expected to become increasingly important once the slumping economy begins to recover. As business picks up, more companies will be shipping products to their customers, so demand for trucking and other freight haulers will improve as well."

The Thrall deal was accomplished for about $353 mm in cash and stock. The good news is the deal adds to car building capacity and product line at TRN; the bad news is that car building is depressed and its doubtful we'll ever see 50,000 cars a year again as rail carriers turn cars faster and industries run private fleets smarter. The Thrall and Duchessois families may have lived through their share of slumps by prudently husbanding funds during boom, but their abrupt exit would appear very negative for the industry.

Among analysts the top three recommendations are GNWR, CNI, and CSX. The technical side rates only GBX a buy based on an oversold condition and "a good entry point." Market watchers may disagree. Elsewhere, Wachovia Securities initiated coverage of Florida east Coast Industries (NYSE: FLA) with a neutral; CSFB initiated coverage of CP with a hold.

Regarding CP, my friend and fellow stock-watcher Chris Rooney writes, "Shorts probably grew because the arbitrage types at Merrill Lynch had probably shorted the CP mother ship temporarily. This to prepare for a long position in order to create CP HOLDERS (a synthetic CP for those who continue to want to own the conglomerate after its breakup in late September). A second rationale may be because already long holders would short a percentage of parent shares held in order to get protection while waiting for the distribution of subsidiary shares (parts worth more than whole idea)."

San Jacinto Rail Limited (SJRL) and The Burlington Northern and Santa Fe Railway Company (BNSF) filed their STB petition for approval to build and operate the proposed 13-mile rail line into Houston's Bayport Industrial District (WIR 8/25). San Jacinto Rail is a limited partnership comprised of: BNSF and affiliates of BNSF; ATOFINA Petrochemicals, Inc.; Basell USA Inc.; Equistar Chemicals, LP; and Lyondell Chemical Company.

According to the press release, the mission of the partnership is to introduce and provide competitively priced rail service options that are sensitive to public safety and the environment. The proposed line would be operated by BNSF and would run just south of Ellington Field and extend to the end of the Bayport Industrial District, just east of state highway 146.

The estimated construction cost of the project is $80 million, which includes construction of six public road crossings including an overpass for Red Bluff Road, to handle traffic safely. No properties within residential neighborhoods will be required to build the new rail line. Additional information about the project is located on the San Jacinto Rail Limited Web site at www.sanjacintorail.com.

The 10-Qs for the period ending 6/30/2001 are beginning to arrive on my doorstep. Burlington Northern and Santa Fe (BNI) and GNWR showed up this week. You may have read about the Financial Accounting Standards Board (FASB) decision on goodwill amortization (literally, "putting to death"). Statement of Accounting Financial Standards (SAFS) No. 142 eliminates the amortization of goodwill, and provides specific steps for testing the impairment of goodwill.

BNI says simply, "The Company's historical consolidated financial statements will be unaffected by these new standards." GNWR, on the other hand, has determined that "goodwill and intangible assets that have indefinite useful lives will not be amortized but rather will be tested at least annually for impairment. Intangible assets that have finite useful lives will continue to be amortized over their useful lives.

"In accordance with this statement, the Company will adopt Statement 142 as of January 1, 2002 for existing goodwill and intangible assets and upon entering into any new business combinations subsequent to June 30, 2001. As of June 30, 2001, goodwill, net of accumulated amortization, is $8.1 million and amortization expense for the six months ended June 30, 2001 is $256,000. The Company has not yet determined the impact that Statement 142 will have on the Company's financial condition or results of operations."

The argument continues as to whether we're in a recession, getting closer to one, or emerging from a downturn. Friday's WSJ (www.wsj.com) surveys several economists and the results are far from conclusive. One camp maintains that "tax rebates and lower short-term interest rates are expected to boost growth during the second half of the year." Thus those who take the traditional view of a recession -- two straight quarters of contraction in total economic output as measured by GDP – may have a point.

The alternative view is that 2Q01 "marked the fourth straight quarter during which the economy expanded at less than 2%. That is the first time on record, going back to 1946, that the economy has expanded for four straight quarters at such a sluggish pace." The argument continues, "this prolonged stretch of extremely sluggish growth could be considered a recession in its own right." In other words, you pays your money and you makes your choice.

Roy Blanchard

Disclosure: Blanchard may from time to time hold long, short, or debt positions in the companies mentioned here. A list of such holdings is available on request.