

# Focus Stock: Trinity Industries

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*U.S. oil boom is lifting demand for railcars.*

The Focus Stock for the week ended May 19 is Trinity Industries, which carries S&P Capital IQ's highest investment recommendation of 5-STARs, or "strong buy." We expect Trinity, a leading manufacturer and lessor of railcars, to benefit from surging U.S. oil and natural gas production, which is being increasingly shipped via railcars.

While the overall U.S. economy is currently still experiencing only tepid growth, Trinity has seen much stronger demand and revenue growth due to its position as a supplier of railcars to the energy sector. This has more than offset weakness in demand for railcars used to carry coal, for which demand has declined due in part to cheap natural gas. We think this is a trend that is likely to go on for years.

We believe Trinity is well positioned to profit from rising oil and gas production in the U.S. The International Energy Agency estimates that by 2020, U.S. oil production will rise by 57% from its rate of 7.0 million barrels per day at the end of 2012. Much of the new production coming on stream is located in areas that are not well served by pipeline, and therefore must be transported by rail. Trinity's largest business is the manufacture and sale of railcars and its third-largest business is leasing railcars. Backlog for new railcars rose to a record \$5.1 billion at the end of the 2013 first quarter, while the leasing fleet is 99% utilized with renewals coming at favorable rates.

Dallas-based Trinity Industries makes railcars, and energy, industrial and construction products primarily for the North American market. In 2012, foreign customers [mainly in Mexico] accounted for 10% of

revenues. The company employs a multi-faceted business model targeted at smoothing earnings across the business cycle.

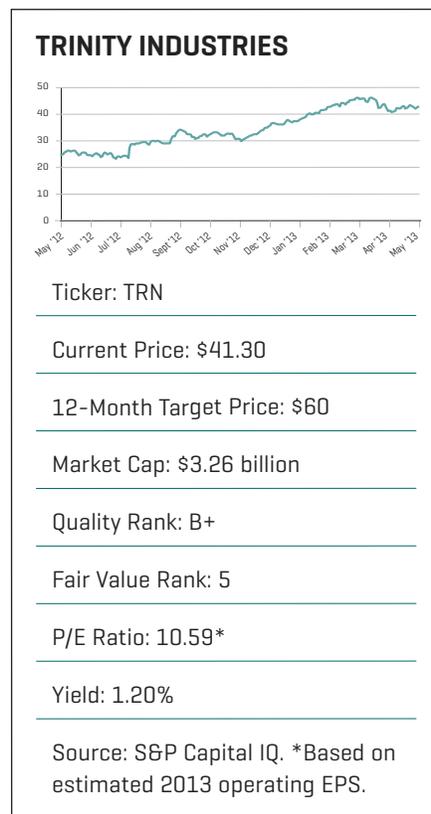
The rail group [40% of 2012 revenues] makes different types of railcars, including pressure and non-pressure tank cars, hoppers and intermodal freight cars. The construction group [12% of 2012 revenues] makes highway guardrail and barrier systems and girders, as well as concrete and aggregates, including ready-mix concrete, aggregates and baggage handling systems. Energy equipment [13%] produces structural wind towers and propane tanks. The inland barge group [18%] produces river hoppers, inland tank barges, and fiberglass barge covers. Trinity is the

largest U.S. producer of inland barges, and one of the largest producers of fiberglass barge covers. Railcar leasing and management services [17%] leases specialized railcars to industrial companies. As of December 31, 2012, the lease fleet included about 57,000 owned or leased railcars that were 98.4% utilized. Trinity believes its leasing business helps it develop long-term relationships with end users while generating a stable earnings stream that reduces its vulnerability to cycles.

Trinity reported first quarter operating earnings per share (EPS) of \$0.91, a 38% increase over the prior year and better than we had expected. While revenues were a bit lighter than we expected, rising 4.1%, rail group revenues advanced 34% and rail group operating profit more than doubled. Trinity currently has a backlog of 41,265 railcars on order, which, according to our calculations, amounts to about eight months of production. During the first quarter, Trinity shipped 5,230 cars while receiving orders for 14,505, a very healthy rate in our opinion.

The lower revenue growth for the quarter versus our expectations came, in our view, from the sale of fewer railcars from the leasing fleet as well as from a drop in revenues at the construction and barge groups. We expect both of these groups to see increasing demand, as we see stronger U.S. economic growth leading to more construction activity and demand for barges to transport goods and services.

In addition, demand for railcars is supported by the need to replace aging fleets. According to industry



*[Continued on page 7]*

# The “Best” Three Ways

**Isabelle Sender**  
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Editorial

*Stocks with top rankings in three qualitative measures.*

In light of S&P Capital IQ’s “Best on the Street” showing earlier this month in which six S&P Capital IQ equity analysts garnered recognition in *The Wall Street Journal*’s annual survey, we sought to isolate for our readers stocks that rank best in three different S&P Capital IQ qualitative measures.

We screened for companies among our ranked universe of equities by 1.) STARS 2.) S&P Quality Ranking and 3.) S&P’s Qualitative Risk Assessment. STARS convey the analyst’s expectation of future price appreciation. Quality rankings provide a long-term outlook for the quality of earnings and dividend stream by assessing their growth and stability. About 3,100 companies are assigned

## STOCK SCREEN OF THE WEEK

COMPANY / TICKER	QUALITY RANKING	STYLE	CURRENT PRICE	12 MONTH TARGET PRICE	P/E (TTM)	YIELD
Aflac / AFL	A-	Growth	\$54.32	\$62.00	7.8	2.5%
Chevron / CVX	A+	Blend	\$122.76	\$142.00	9.1	3.2%
Coca-Cola / KO	A+	Growth	\$43.09	\$48.00	19.4	2.6%
ExxonMobil / XOM	A+	Blend	\$90.70	\$104.00	10.6	2.7%
J.M. Smucker / SJM	A	Blend	\$103.32	\$110.00	20.0	2.0%

Source: S&P Capital IQ. Quality Rankings are defined on page 2.

Quality Rankings. Initiated in 2004, qualitative risk reflects risk factors related to a company’s operations as opposed to risk and volatility measures associated with a company’s share price.

The stocks the screener returned are top-ranked, 5-STARS U.S. equities

with an A- or better S&P Quality Ranking and a “low” Qualitative Risk Assessment.

In addition to high qualitative measures they all share, the stocks all also recently paid a dividend yielding at least 2%. ■

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data, the average age of the railcar fleet owned by railroads is currently 23.7 years, with close to half the fleet more than 30 years old and in need of replacement. In particular, the tank car fleet is the oldest with an average age of 32 years. We think that replacement of aging railcars will help put a floor under demand even as the economy remains uncertain. Economic acceleration, if it occurs, should help increase capital spending to replace aging equipment, but we think a certain level of replacement demand is likely even if economic improvement does not occur.

Our 2013 revenue estimate is \$4.4 billion, representing 13% growth over 2012. We see revenue growth of 31%

in the rail group, partly offset by lower revenues in the barge segment. For 2014, we see revenues growing an additional 19% to \$5.25 billion. Growth in both years should be supported by strong demand for railcars, and increased energy products demand on an improving U.S. economy. We estimate operating EPS estimate of \$3.94 in 2013, 24% growth over 2012. For 2014, we see EPS rising a further 13%, to \$4.44.

We view the shares as significantly undervalued at current levels. Trinity’s stock is currently trading at about 10.7-times our 2013 EPS estimate of \$3.94 and 9.5-times our 2014 EPS estimate of \$4.44. This compares to a 10-year historical price/earnings [P/E]

range of 3-27 earnings. Our 12-month target price of \$60 values the shares at 15-times our 2013 estimate and 13.5-times our 2014 estimate, in the middle of the range. This is warranted, in our view, by the strong revenue and earnings growth we foresee.

While Trinity’s stock has been a strong performer this year, rising 17% year to date, we do not think the current fundamentals and earnings growth we see are appropriately reflected in the stock price. We expect the shares to outpace the S&P 500 over the next year and our 12-month target price of \$60 represents about 43% potential appreciation. In addition, the stock has a dividend yield of about 1.2%, adding an income component as well. ■