



BY GENE G. MARCIAL

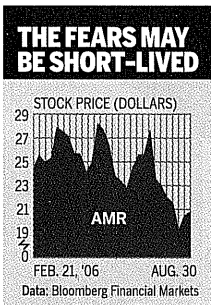
FOR AMERICAN AIRLINES, THE ONLY WAY IS UP, SOME ARGUE.

SUITORS COULD COME CALLING AT UNDERVALUED SCHOLASTIC.

ZENITH'S INSURANCE EARNINGS KEEP UP THE STEADY GROWTH.

AMR: Above the Storms

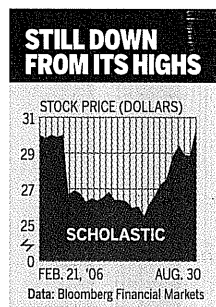
TERRORIST THREATS AND LOFTY oil prices have shaken airline passengers and investors alike. Little wonder, then, that airline stocks have slumped 20% to 30% so far this year. But some fund managers say now is the time to buy. "Contrary to dire forecasts, airlines will post heady profits in 2007-08," says Vincent Carino, president of Brookhaven Capital Management. His top pick: AMR (AMR), parent of No. 1 American Airlines, whose shares tumbled from 30 in May to 20.83 on Aug. 30. AMR was featured in this column on Mar. 28, 2005, when it traded at 8.65. With revenues on the rise and costs flat to down, AMR's margins are fattening, notes Carino, whose firm owns shares. He thinks the industry's woes are fully reflected in the price. "Any drop in oil or easing in hurricane worries will drive up the stock," he argues. If oil averages \$70 a barrel, AMR, which he expects to earn \$1.90 a share this year, will make \$4.50 next year. And if it drops to \$50, he figures earnings will hit \$8. Daniel McKenzie of Credit Suisse says investors who see past the current "ugly tape and look to next year will be rewarded." Concerns are outweighed, he says, by "our outlook that AMR can report near-record earnings in 2007." He rates AMR "outperform" with a 12-month target of 35. Zacks Investment puts consensus 2007 estimates at \$3.52 a share and 2008 at \$4.57, vs. a \$4.10 loss in 2005. Fidelity owns 22 million AMR shares, or a 10% stake, after buying 1.6 million in June.



Did Scholastic Deserve That Punishment?

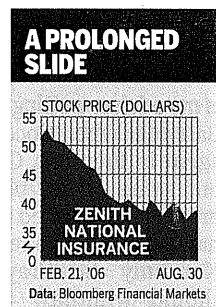
CHILDREN'S BOOK PUBLISHER Scholastic (SCHL) is getting poor marks on the Street. Its fiscal fourth-quarter profits came in below consensus forecasts, and only two of the eight analysts who follow it now rate it a "buy." But one bull, Ivan Feinseth of Matrix Investment Research, says Scholastic, now at 30.10, has an intrinsic value in the mid-to-high 30s. Michael Metz of Oppenheimer says Scholastic is so undervalued that it "keeps showing up in our screens of buyout candidates." He thinks it's worth 40 in a sale to private equity players, who would be drawn to its assets and cash flow. In the 12 months through mid-2006,

notes Feinseth, Scholastic's free cash flow has shot up from \$7 million to \$200 million, while excess cash per share jumped from \$1.55 to \$3.75. Drew Crum of Stifel Nicolaus, who also pegs it a "buy," says 2007 will be a better year for textbook sales. Also, sales of \$195 million worth of Harry Potter books should add 60¢ to 2006 earnings, figures Crum. He calls the stock "compelling" and sees earnings of \$1.65 for the year ending May, 2007, rising to \$2.35 in fiscal 2008, vs. \$1.69 this year.



Zenith Is 'Best-in-Class' For Workers' Comp

ZENITH NATIONAL INSURANCE (ZNT) specializes in what looks like a boring business: workers' comp insurance. But "we love boring when it delivers steady earnings growth, which Zenith has done for the past seven years," says Michael Camp, a principal at Northwest Criterion Asset Management, which owns shares. The stock, now at 38.67, down from 55 on Jan. 31, is cheap, he adds. Matthew Carletti of investment outfit Cochran Caronia Waller upped his 2006 earnings estimate from \$5.60 a share to \$6.10 based on better-than-expected results in the second quarter. Zenith earned \$3.73 last year. He says Zenith is "best-in-class," leading its peers in operating results and customer retention. By law, companies must insure employees against disability or death. Zenith's workers' comp premiums, mainly from California and Florida, accounted for 94% of 2005 revenues; the other 6% came from reinsurance, a business it had exited by yearend. Carletti sees Zenith's book value rising 50%, to \$31.75, by the end of 2008, thanks to strong earnings growth and less need to build reserves against losses. Carletti's 12-month stock price target: 45. ■■



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