

Kansas City Southern (KSU)

\$185.42 (As of 08/06/20)

Price Target (6-12 Months): **\$197.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/23/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: B

Growth: C

Momentum: D

Summary

Shares of Kansas City Southern have outperformed its industry in a year's time, mainly due to improved efficiencies. Increased efficiency and reduced costs, thanks to the precision-scheduled railroading model, are helping the company better deal with coronavirus-related woes. With economies having opened up, we are optimistic about improving volumes. Overall carload volumes have increased 39% after having bottomed in early May. However, volumes are still below year-ago levels. Given the ongoing coronavirus concerns and economic weakness, a recovery is not likely to happen any time soon. The anticipated softness in volumes is expected to keep Kansas City Southern's top line (fell 23% in second-quarter 2020) under pressure. Amid uncertainties, the company withdrew 2020 guidance for revenues, volumes, operating ratio and earnings.

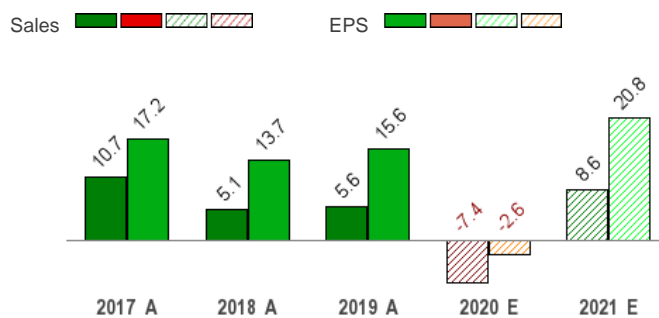
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$195.47 - \$92.86
20 Day Average Volume (sh)	1,350,204
Market Cap	\$17.5 B
YTD Price Change	21.1%
Beta	0.96
Dividend / Div Yld	\$1.60 / 0.9%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 27% (185 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.7%
Last Sales Surprise	-0.4%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	10/16/2020
Earnings ESP	0.0%
P/E TTM	27.0
P/E F1	27.6
PEG F1	1.8
P/S TTM	6.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	740 E	712 E	731 E	737 E	2,884 E
2020	732 A	548 A	667 E	707 E	2,655 E
2019	675 A	714 A	748 A	730 A	2,866 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.07 E	\$1.98 E	\$2.04 E	\$2.05 E	\$8.12 E
2020	\$1.96 A	\$1.15 A	\$1.69 E	\$1.87 E	\$6.72 E
2019	\$1.54 A	\$1.64 A	\$1.94 A	\$1.82 A	\$6.90 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/06/2020. The reports text is as of 08/07/2020.

Overview

Based in Kansas City, MO, Kansas City Southern is a transportation holding company that has railroad investments in the United States, Mexico and Panama.

The company was formerly known as Kansas City Southern Industries Inc. and changed its name to Kansas City Southern in 2002. Its U.S. holding is the Kansas City Southern Railway Company (KCSR), serving central and south central United States. Kansas City Southern controls and owns 100% shares of KCSR, founded in 1887. KCSR provides service to a ten-state region in the midwest and southeast regions of the United States.

Kansas City Southern through its various subsidiaries and alliances, provides rail transportation services over a network of more than 25,000 route miles across the United States, Canada and Mexico. The company's coordinated rail network provides shippers with an effective alternative by giving direct access to Mexico, the south-east and south-west United States through less congested interchange hubs.

Revenue are generated from haulage of chemicals and petroleum (This commodity group includes products such as chemicals, plastics, petroleum, liquefied petroleum gas, and petroleum refined products, such as gasoline and diesel), industrial and commercial products (forest products as well as metals and scrap), agricultural and mineral products (consists primarily of grain and food products), intermodal (road and rail) automotive products (it offers rail transportation to the entire automotive industry supply chain), energy (includes coal, frac sand, petroleum coke and crude oil) and others. Below we present the contribution of each sector to the top line in 2019.

Industrial & Consumer Products - 21.3%

Chemical & Petroleum - 25.7%

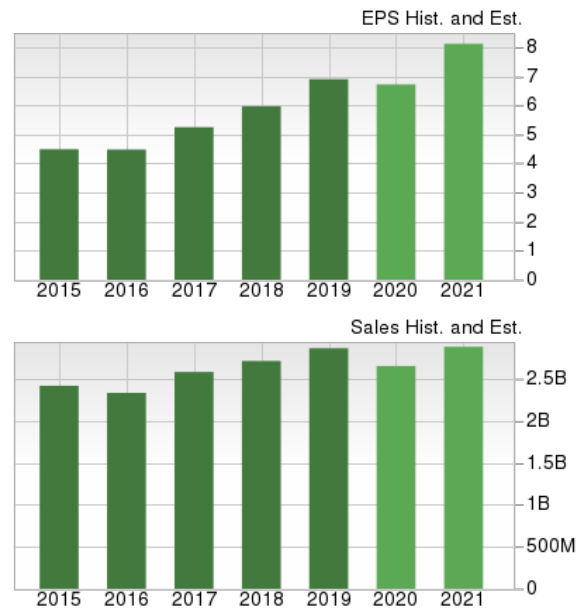
Agriculture & Minerals - 17.7%

Energy - 8.6%

Intermodal - 12.9%

Automotive - 8.9%

Other revenues - 4.9%



Reasons To Buy:

- ▲ Benefits of the precision-scheduled railroading ("PSR") model in the form of reduced costs and increased efficiency are helping Kansas City Southern better deal with coronavirus-related challenges. Thanks to the PSR model, transportation operating expenses reduced 27% in June from that in January. Meanwhile, mechanical and engineering expenses reduced by 29% and 9% respectively in June from January. In 2019, the company realized PSR savings of \$58 million. In 2020, it expects to generate PSR savings of \$95 million.
 - ▲ The signs of gradual recovery in volumes are encouraging. With the reopening of economies, Kansas City Southern has been witnessing modest improvement in volumes. During the second-quarter earnings call, management stated that overall carload volumes have increased approximately 39% after having bottomed in early May.
 - ▲ Trump's decision to indefinitely suspend plans of a 5% tariff on all goods imported from Mexico bodes well for Kansas City Southern. This is because the company generates a significant amount of revenues from Mexico. The announcement of a rollback in tariffs, made in June 2019, came after Mexico agreed to strengthen immigration enforcement. The United States–Mexico–Canada Agreement (USMCA) agreement, which came into force on Jul 1, is a major boon to the company. Replacing the 25-year old North American Free Trade Agreement (NAFTA), the USMCA streamlines North American trade and is expected to drive growth of Kansas City Southern through increased volumes.
 - ▲ We are optimistic about Kansas City Southern's resumption of share repurchases in the second quarter. The company attributed this decision to the improving volumes. During the second quarter, it repurchased 699,000 shares at an average price of \$143.05. Return to shareholders is up 72% year-to-date (as of Jul 17), thanks to 106% increase in share repurchases. The company's solid free cash flow generation capacity should lead to increase in such shareholder-friendly activities. Kansas City Southern's year-to-date (as of Jul 17) free cash flow is up 35% year-over-year. The company is committed to generate free cash flow of \$500 million or more in 2020. Moreover, Kansas City Southern's short-term debt stood at \$16.3 million at the end of the second quarter, way below cash and cash equivalents of \$620.1 million, indicating that the company has sufficient cash to meet its short term debt obligations.
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Amid challenges, the precision scheduled railroading model is aiding the company.

Reasons To Sell:

- ▼ Due to the uncertainty emanating from the coronavirus pandemic, the company withdrew its previously announced 2020 projections for revenues, volumes, operating ratio and earnings per share. The projection for 2020 capital expenditures has been reduced to \$425 million (could be even less). This might dent the company's growth prospects.
- ▼ Although volumes have improved from the lows in April and early May, it is still below year-ago levels. Given the ongoing coronavirus concerns and economic weakness, a recovery is not likely any time soon. The anticipated softness in volumes is expected to keep Kansas City Southern's top line under pressure. Evidently, the company's top line fell 23% year over year in the second quarter due to low volumes (plunged 21%).
- ▼ While the reopening of economies has had a positive impact on almost all segments, a few segments continue to experience substantial weakness. In the industrial and consumer business unit, the company's metals business is still significantly below year-ago levels. Moreover, with regard to the energy business, the company does not expect crude shipments to recover in the near-term. Additionally, the company's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 13.8% compares unfavorably with ROE of 24.9% for its industry and 16.9% for the S&P 500 index, of which Kansas City Southern is a key member.

Coronavirus-related volume softness is likely to keep the company's top line under pressure.

Last Earnings Report

Kansas City Southern Beats on Earnings in Q2

Kansas City Southern's second-quarter 2020 earnings (excluding a penny from non-recurring items) of \$1.15 per share beat the Zacks Consensus Estimate of \$1.12. However, the bottom line declined approximately 30% year over year due to decline in demand as a result of coronavirus.

Meanwhile, quarterly revenues of \$547.9 million lagged the Zacks Consensus Estimate of \$550.2 million. Moreover, the top line fell 23% year over year due to weak volumes. Overall carload volumes plunged 21% year over year with declines across all segments.

In the reported quarter, operating income (on a reported basis) declined 13.3% to \$180.4 million. Moreover, operating income (on an adjusted basis) fell 26.3% to \$190.9 million. Kansas City Southern's adjusted operating ratio (operating expenses as a percentage of revenues) deteriorated to 65.2% from 63.7% a year ago. The lower the value of the metric the better. Operating expenses (adjusted) in the quarter declined 21.5% year over year.

Segmental Details

The Chemical & Petroleum segment generated revenues worth \$158.5 million, down 16% year over year. Volumes declined 13% year over year. Revenues per carload also dipped 3% from the prior-year quarter.

The Industrial & Consumer Products segment's revenues logged \$120.6 million, down 20% year over year. Business volumes and revenues per carload decreased 14% and 7% respectively, on a year-over-year basis.

The Agriculture & Minerals segment's total revenues decreased 7% to \$114.4 million. Business volumes slipped 7% while revenues per carload were flat on a year-over-year basis.

The Energy segment's revenues of \$39.3 million were down 27% year over year. While business volumes decreased 19% year over year, revenues per carload dropped 10%.

Intermodal revenues were \$63.5 million, down 31% year over year. While business volumes dropped 22%, revenues per carload declined 12% year over year.

Revenues in the Automotive segment plunged 78% year over year to \$15.6 million. While business volumes fell 73%, revenues per carload declined 19% on a year-over-year basis.

Other revenues totaled \$36 million, up 1% year over year.

Outlook

The company anticipates capital expenditures of \$425 million or less in 2020. For the period 2021-2022, capital expenditures are still expected to be roughly 17% of revenues. The company is committed to generate free cash flow of \$500 million or more in 2020.

Quarter Ending **06/2020**

Report Date	Jul 17, 2020
Sales Surprise	-0.42%
EPS Surprise	2.68%
Quarterly EPS	1.15
Annual EPS (TTM)	6.87

Recent News

Dividend Update — May 21, 2020

The company's board of directors declared a regular quarterly dividend of 40 cents per share on all outstanding common shares of the company. This dividend will be paid on Jul 8, 2020, to shareholders on Jun 8.

The company's board also declared a regular dividend of 25 cents per share on the outstanding 4% non-cumulative preferred stock of the company. The dividend will be paid on Jul 7, 2020 to preferred stockholders of record on Jun 8.

Valuation

Kansas City Southern shares are up 15.3% and 55.6% in the year-to-date period and over the trailing 12-month period respectively. Stocks in the Zacks sub-industry and the Zacks Transportation sector are up 1.9% but down 5% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry is up 8%, while the sector is down 0.3%.

The S&P 500 index is up 3.2% and 13.5% in the year-to-date period and in the past year respectively.

The stock is currently trading at 26.99X trailing 12-month price-to-earnings, which compares to 21.29X for the Zacks sub-industry, 17.58X for the Zacks sector and 23.5X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.99X and as low as 14.3X, with a 5-year median of 19.93X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$197 price target reflects 28.71X trailing 12-month earnings.

The table below shows summary valuation data for KSU

Valuation Multiples - KSU					
		Stock	Sub-Industry	Sector	S&P 500
P/E TTM	Current	26.99	21.29	17.58	23.5
	5-Year High	26.99	22.72	19.57	23.5
	5-Year Low	14.3	13.73	11.63	15.98
	5-Year Median	19.93	19.84	15.58	19.2
EV/EBITDA TTM	Current	14.39	14.4	7.93	12.89
	5-Year High	17.18	31.25	11.22	12.89
	5-Year Low	8.48	7.86	5.47	8.24
	5-Year Median	11.3	12.23	7.39	10.89
P/S F12M	Current	6.26	5.86	1.27	3.63
	5-Year High	6.26	5.86	1.42	3.63
	5-Year Low	2.83	3.04	0.85	2.53
	5-Year Median	4.04	4.57	1.2	3.04

As of 08/06/2020

Industry Analysis Zacks Industry Rank: Bottom 27% (185 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Canadian National Railway Company (CNI)	Outperform	2
Canadian Pacific Railway Limited (CP)	Outperform	2
Berkshire Hathaway Inc. (BRK.B)	Neutral	2
Caterpillar Inc. (CAT)	Neutral	3
CSX Corporation (CSX)	Neutral	3
Norfolk Southern Corporation (NSC)	Neutral	3
Union Pacific Corporation (UNP)	Neutral	3
WEST JAPAN RAIL (WJRY)	Neutral	4

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	KSU	X Industry	S&P 500	CSX	NSC	UNP
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	C	-	-	C	C	C
Market Cap	17.49 B	21.14 B	23.20 B	55.29 B	53.92 B	121.93 B
# of Analysts	8	7	14	10	10	10
Dividend Yield	0.86%	1.65%	1.78%	1.44%	1.92%	2.16%
Value Score	B	-	-	B	B	B
Cash/Price	0.04	0.05	0.07	0.05	0.02	0.02
EV/EBITDA	16.49	12.29	13.21	10.75	12.49	13.22
PEG Ratio	1.84	2.71	2.94	2.70	3.12	2.33
Price/Book (P/B)	3.69	3.66	3.12	4.55	3.63	7.41
Price/Cash Flow (P/CF)	17.15	13.11	12.27	12.08	13.11	15.33
P/E (F1)	27.56	23.25	21.69	20.57	22.21	23.25
Price/Sales (P/S)	6.35	5.16	2.48	5.04	5.27	6.04
Earnings Yield	3.62%	4.14%	4.39%	4.86%	4.51%	4.30%
Debt/Equity	0.81	0.81	0.77	1.33	0.85	1.61
Cash Flow (\$/share)	10.81	6.11	6.94	5.98	14.93	11.72
Growth Score	C	-	-	C	D	C
Hist. EPS Growth (3-5 yrs)	11.73%	12.62%	10.46%	23.81%	18.89%	13.50%
Proj. EPS Growth (F1/F0)	-2.61%	-11.20%	-6.80%	-15.73%	-14.74%	-7.82%
Curr. Cash Flow Growth	8.60%	1.21%	5.39%	0.86%	3.26%	-0.27%
Hist. Cash Flow Growth (3-5 yrs)	5.61%	5.61%	8.55%	8.74%	5.66%	2.78%
Current Ratio	2.44	1.08	1.33	1.62	1.21	0.96
Debt/Capital	44.59%	45.91%	44.50%	57.01%	45.91%	61.64%
Net Margin	20.63%	20.55%	10.13%	26.39%	20.47%	27.54%
Return on Equity	13.80%	15.46%	14.39%	24.24%	16.06%	32.45%
Sales/Assets	0.28	0.32	0.51	0.28	0.27	0.32
Proj. Sales Growth (F1/F0)	-7.37%	-8.54%	-1.51%	-12.15%	-13.31%	-11.40%
Momentum Score	D	-	-	F	D	F
Daily Price Chg	5.00%	1.16%	-0.04%	1.18%	1.40%	1.21%
1 Week Price Chg	11.09%	-0.15%	0.14%	0.00%	2.78%	-1.57%
4 Week Price Chg	29.81%	10.50%	7.78%	6.50%	14.55%	8.21%
12 Week Price Chg	38.26%	17.82%	17.48%	14.77%	17.52%	17.82%
52 Week Price Chg	55.61%	5.84%	0.68%	8.29%	8.45%	5.84%
20 Day Average Volume	1,350,204	281,263	2,057,775	3,447,410	1,496,511	2,952,210
(F1) EPS Est 1 week change	0.30%	0.00%	0.00%	0.00%	0.30%	0.00%
(F1) EPS Est 4 week change	-0.22%	0.13%	1.36%	-1.54%	0.25%	0.56%
(F1) EPS Est 12 week change	-1.57%	-2.29%	1.57%	-3.01%	-3.10%	0.21%
(Q1) EPS Est Mthly Chg	-1.98%	0.91%	0.54%	2.04%	0.49%	-0.58%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	C
Momentum Score	D
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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