

Kansas City Southern (KSU)

\$131.33 (As of 05/07/20)

Price Target (6-12 Months): **\$139.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/23/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:C

Value: D

Growth: B

Momentum: D

Summary

Shares of Kansas City Southern have outperformed its industry in a year's time, primarily owing to improved efficiencies. Increased efficiency on the adoption of the precision scheduled railroading model aided the bottom line in 2019 and the first quarter of 2020 was no different. The company's outperformance was backed by strength in the Chemicals and Petroleum segment. Also, courtesy of its cost-control efforts, operating ratio improved to 59.7% from 66.2% a year ago. However, 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. As it has significant exposure to Mexico, rapid spread of the coronavirus cases in the country is a concern and might cause a reduction in the Mexican crew size.

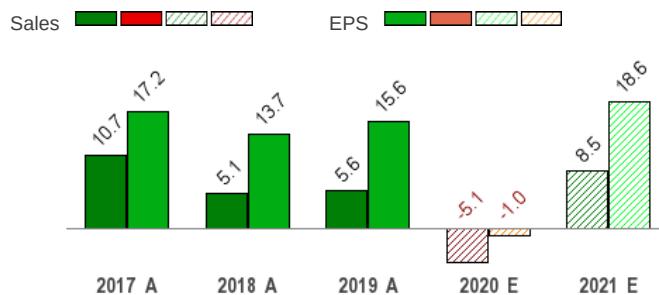
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$178.59 - \$92.86
20 Day Average Volume (sh)	1,325,943
Market Cap	\$12.5 B
YTD Price Change	-14.3%
Beta	0.88
Dividend / Div Yld	\$1.60 / 1.2%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 28% (182 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	15.3%
Last Sales Surprise	2.4%
EPS F1 Est- 4 week change	-12.1%
Expected Report Date	07/17/2020
Earnings ESP	0.0%
P/E TTM	17.8
P/E F1	19.2
PEG F1	1.3
P/S TTM	4.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	761 E	725 E	773 E	765 E	2,951 E
2020	732 A	596 E	684 E	724 E	2,721 E
2019	675 A	714 A	748 A	730 A	2,866 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.07 E	\$1.99 E	\$2.17 E	\$2.10 E	\$8.10 E
2020	\$1.96 A	\$1.32 E	\$1.73 E	\$1.82 E	\$6.83 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 05/07/2020. The reports text is as of 05/08/2020.

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%

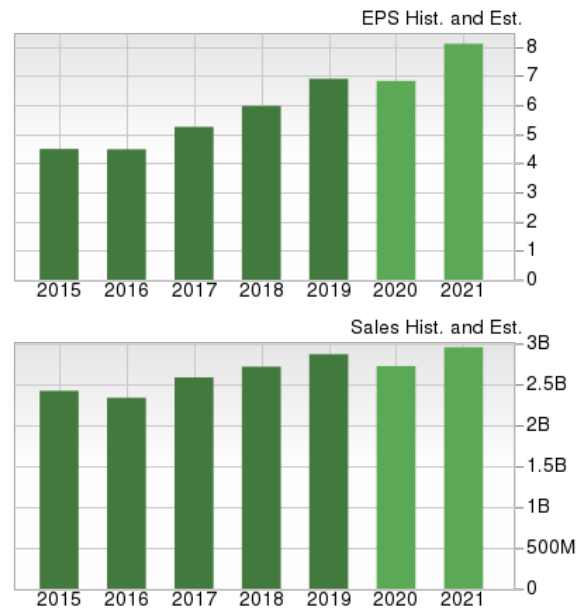
Agriculture & Minerals - 17.7%

Energy - 8.6%

Intermodal - 12.9%

Automotive - 8.9%

Other revenues - 4.9%



Reasons To Buy:

- ▲ We are positive about Kansas City Southern's adoption of the precision scheduled railroading model. Through this initiative, the company aims to improve operational efficiencies and reduce network congestion. In fact, an improved operational performance owing to the adoption of this model aided results in 2019 and the first-quarter of 2020 was no different. Overall, carload volumes increased 4% year over year in the March-end quarter, mainly on the double-digit volume expansion in the Chemical and Petroleum segment.
 - ▲ Improvement in adjusted operating ratio (operating expenses as a percentage of revenues) is an added positive and can be attributed to the company's efforts to cut costs. In first quarter 2020, operating ratio improved to 59.7% from 66.2% a year ago.
 - ▲ 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 debt-to-capitalization ratio, which is an indicator of the company's leverage, stood at 0.4, 0.34, 0.35 and 0.36 at the end of 2019, 2018, 2017 and 2016, respectively. The readings compare favorably with the respective numbers for its industry of 0.53, 0.49, 0.41 and 0.44. A low debt to capitalization ratio indicates that the proportion of debt to finance the company's assets is not on the rise
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Improvement in operating ratio is a huge positive for 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 company aims to generate free cash flow of \$500 million or more in 2020. The projection for 2020 capital expenditures has been reduced to \$450 million, with a further reduction of \$50 million possible by Jun 30. This might dent the company's growth prospects.
- ▼ Kansas City Southern has a significant exposure to Mexico. Consequently, the rapid spread of coronavirus cases in the country is a concern and might lead to a reduction in Mexican crew size.
- ▼ Additionally, the company's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 14.4% compares unfavorably with ROE of 26.7% for its industry and 18.5% for the S&P 500 index, of which Kansas City Southern is a key member.

Weak volumes in key sectors are hurting Kansas City Southern's rail traffic. The change in Mexico fuel excise tax credit, which eliminates a tax credit for locomotives is an added concern.

Last Earnings Report

Kansas City Southern Beats on Earnings in Q1

Kansas City Southern's earnings (excluding 38 cents from non-recurring items) of \$1.96 beat the Zacks Consensus Estimate by 26 cents. Moreover, the bottom line improved 27.3% on a year-over-year basis on the back of better operational efficiency.

The company also reported better-than-expected revenues. Quarterly revenues of \$731.7 million surpassed the Zacks Consensus Estimate of \$714.5 million. Moreover, the top line improved 8.4% year over year, mainly owing to strong performances at the Chemicals and Petroleum and the Intermodal units. Overall, carload volumes increased 4% year over year, mainly on the double-digit volume expansion in the Chemical and Petroleum segment.

In the reported quarter, operating income (on a reported basis) soared 80.8% to \$288.8 million. Moreover, operating income (on an adjusted basis) rose 29.4% to \$294.8 million. Kansas City Southern's adjusted operating ratio (operating expenses as a percentage of revenues) improved to 59.7% from 66.2% a year ago.

Segmental Details

The Chemical & Petroleum segment generated revenues worth \$198.6 million, up 18% year over year. Volumes expanded 14% year over year. Revenues per carload also climbed 3% from the prior-year quarter.

The Industrial & Consumer Products segment's revenues logged \$159 million, up 6% year over year. Business volumes and revenues per carload were up 4% and 2%, respectively, on a year-over-year basis.

The Agriculture & Minerals segment's total revenues increased 9% to \$134.5 million. Business volumes were up 2% and revenues per carload improved 8% on a year-over-year basis.

The Energy segment's revenues of \$56.3 million were down 13% year over year. Revenues were hurt by weakness in the Utility Coal (down 27%) and Frac Sand (down 53%) sub-groups. While business volumes decreased 5% year over year, revenues per carload dropped 8%.

Intermodal revenues were \$88.7 million, up 11% year over year. While business volumes increased 6%, revenues per carload climbed 5% year over year.

Revenues in the Automotive segment dwindled 6% year over year to \$53.9 million. While business volumes fell 12%, revenues per carload ascended 6% on a year-over-year basis.

Other revenues totaled \$40.7 million, up 30% year over year.

Outlook

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 company aims to generate free cash flow of \$500 million or more in 2020. Capital expenditures are still anticipated to be roughly 17% of revenues in the 2021-2022 period.

Quarter Ending 03/2020

Report Date	Apr 17, 2020
Sales Surprise	2.41%
EPS Surprise	15.29%
Quarterly EPS	1.96
Annual EPS (TTM)	7.36

Valuation

Kansas City Southern shares are down 14.3% in the year-to-date period and up 7.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Transportation sector are down 14% and 27% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry is down 13.2% while the sector is down 25%.

The S&P 500 index is down 11.5% and 0.9% in the year-to-date period and in the past year respectively.

The stock is currently trading at 17.84X forward 12-month price-to-earnings, which compares to 16.73X for the Zacks sub-industry, 11.54X for the Zacks sector and 18.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.53X and as low as 14.3X, with a 5-year median of 19.87X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$139 price target reflects 18.8X forward 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	17.84	16.73	11.54	18.2
	5-Year High	25.53	22.72	19.58	22.17
	5-Year Low	14.3	13.73	11.54	15.91
	5-Year Median	19.87	19.72	15.53	18.95
EV/EBITDA TTM	Current	10.41	11.9	6.01	10.44
	5-Year High	17.18	31.25	11.16	12.86
	5-Year Low	8.48	7.86	5.42	8.28
	5-Year Median	11.24	12	7.36	10.78
P/S F 12M	Current	4.45	4.99	1	3.21
	5-Year High	5.59	5.47	1.42	3.44
	5-Year Low	2.83	3.04	0.85	2.54
	5-Year Median	4.02	4.51	1.2	3.01

As of 05/07/2020

Industry Analysis Zacks Industry Rank: Bottom 28% (182 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Berkshire Hathaway Inc (BRK.B)	Neutral	3
Canadian National Railway Company (CNI)	Neutral	3
Canadian Pacific Railway Limited (CP)	Neutral	3
CSX Corporation (CSX)	Neutral	3
Norfolk Southern Corporation (NSC)	Neutral	3
Union Pacific Corporation (UNP)	Neutral	3
Caterpillar Inc (CAT)	Underperform	5
WEST JAPAN RAIL (WJRY)	Underperform	5

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)	4	-	-	3	3	3
VGM Score	C	-	-	D	D	D
Market Cap	12.48 B	29.88 B	19.51 B	48.93 B	43.44 B	106.01 B
# of Analysts	8	7	14	10	10	10
Dividend Yield	1.22%	2.15%	2.15%	1.63%	2.22%	2.48%
Value Score	D	-	-	C	C	C
Cash/Price	0.01	0.05	0.06	0.05	0.01	0.01
EV/EBITDA	12.45	11.02	11.77	9.83	10.44	11.91
PEG Ratio	1.31	2.42	2.54	2.27	2.67	2.03
Price/Book (P/B)	2.62	2.62	2.67	4.12	2.92	6.63
Price/Cash Flow (P/CF)	12.15	11.36	10.44	10.69	11.36	13.33
P/E (F1)	19.65	19.16	19.30	17.68	18.64	20.26
Price/Sales (P/S)	4.27	4.04	1.99	4.15	3.92	4.92
Earnings Yield	5.20%	5.22%	4.91%	5.66%	5.37%	4.94%
Debt/Equity	0.68	0.79	0.75	1.39	0.79	1.65
Cash Flow (\$/share)	10.81	6.11	7.01	5.98	14.93	11.72
Growth Score	B	-	-	D	C	C
Hist. EPS Growth (3-5 yrs)	11.08%	11.08%	10.87%	23.43%	18.67%	12.65%
Proj. EPS Growth (F1/F0)	-1.05%	-10.01%	-9.87%	-13.31%	-12.01%	-8.01%
Curr. Cash Flow Growth	8.60%	2.96%	5.88%	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	1.32	0.98	1.24	1.73	0.90	0.82
Debt/Capital	40.39%	44.24%	44.23%	58.09%	44.24%	62.25%
Net Margin	20.11%	22.73%	10.68%	27.74%	21.89%	27.85%
Return on Equity	14.63%	16.38%	16.36%	27.27%	18.12%	34.15%
Sales/Assets	0.30	0.34	0.55	0.31	0.30	0.35
Proj. Sales Growth (F1/F0)	-5.04%	-7.96%	-2.26%	-9.84%	-10.59%	-9.08%
Momentum Score	D	-	-	F	F	F
Daily Price Chg	3.21%	0.26%	1.52%	2.06%	0.83%	1.24%
1 Week Price Chg	-2.32%	0.35%	0.53%	1.85%	6.25%	0.35%
4 Week Price Chg	-3.86%	-3.51%	0.73%	-0.13%	6.45%	5.04%
12 Week Price Chg	-24.29%	-23.53%	-21.09%	-19.94%	-19.44%	-15.39%
52 Week Price Chg	7.47%	-16.34%	-10.17%	-18.23%	-16.34%	-11.05%
20 Day Average Volume	1,325,943	689,133	2,398,409	4,787,913	1,513,664	3,414,091
(F1) EPS Est 1 week change	-2.41%	-2.17%	0.00%	-2.17%	-3.19%	-2.53%
(F1) EPS Est 4 week change	-12.09%	-12.09%	-6.95%	-10.48%	-13.33%	-12.18%
(F1) EPS Est 12 week change	-15.07%	-17.56%	-15.68%	-13.31%	-18.49%	-16.74%
(Q1) EPS Est Mthly Chg	-25.76%	-25.26%	-13.12%	-24.76%	-32.11%	-26.50%

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	D
Growth Score	B
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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