

Kansas City Southern (KSU)

\$152.85 (As of 07/14/20)

Price Target (6-12 Months): **\$162.00**

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: C

Growth: B

Momentum: F

Summary

Shares of Kansas City Southern have outperformed its industry in a year's time, mainly due to improved efficiencies. The company's outperformance was backed by strength in Chemicals and Petroleum segments. Increased efficiency on the adoption of the precision scheduled railroading model is aiding its bottom line. Improvement in operating ratio is also a positive. Additionally, with businesses opening up, we are optimistic about improving volumes. Although carloads improved 31% after having bottomed in early May, it is still 8% below pre-coronavirus levels. Due to coronavirus-induced volume declines, the company expects second-quarter revenues of approximately \$550 million, indicating a decline of nearly 23% year over year. Amid uncertainties, the company withdrew 2020 guidance for revenues, volumes, operating ratio and earnings.

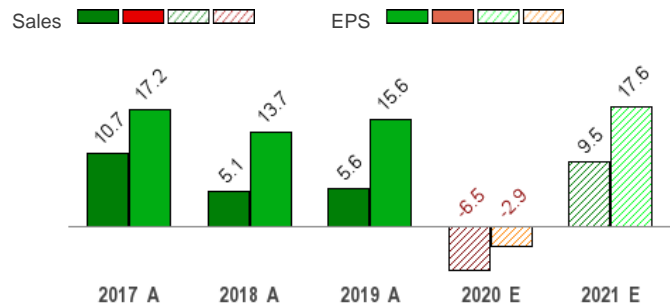
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$178.59 - \$92.86
20 Day Average Volume (sh)	1,061,673
Market Cap	\$14.5 B
YTD Price Change	-0.2%
Beta	0.93
Dividend / Div Yld	\$1.60 / 1.0%
Industry	Transportation - Rail
Zacks Industry Rank	Top 42% (105 out of 251)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	15.3%
Last Sales Surprise	2.4%
EPS F1 Est- 4 week change	-1.8%
Expected Report Date	07/17/2020
Earnings ESP	-2.0%
P/E TTM	20.8
P/E F1	22.8
PEG F1	1.5
P/S TTM	5.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	741 E	747 E	762 E	751 E	2,935 E
2020	732 A	558 E	678 E	717 E	2,680 E
2019	675 A	714 A	748 A	730 A	2,866 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.01 E	\$2.06 E	\$2.13 E	\$2.06 E	\$7.88 E
2020	\$1.96 A	\$1.18 E	\$1.72 E	\$1.82 E	\$6.70 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 07/14/2020. The reports text is as of 07/15/2020.

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%

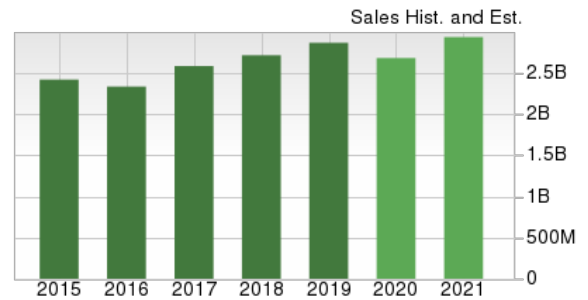
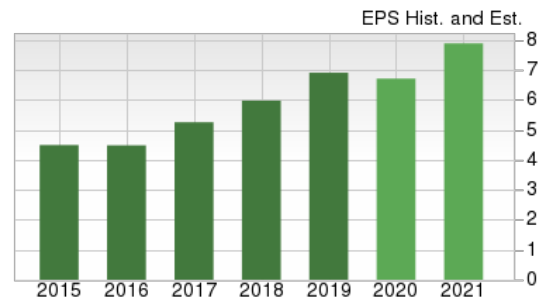
Agriculture & Minerals - 17.7%

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. Amid coronavirus-related challenges, benefits of the precision-scheduled railroading model helped reduce transportation expenses by 16% in May from that in March. Meanwhile, mechanical and engineering expenses reduced by 24% and 11% respectively in May, from March.
- ▲ 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. Additionally, with businesses opening up, the recent improvement in volumes is encouraging. Per the company, carloads improved 31% 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 total debt to total capital 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 capital ratio indicates that the proportion of debt to finance the company's assets is not on the rise

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 company aims to generate free cash flow of more than \$500 million 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.
- ▼ Thanks to coronavirus-induced global economic slowdown, Kansas City Southern's second quarter (releasing on Jul 17) volumes and revenues plunged 23% and 24% (from year-ago levels) respectively, as of Jun 21. For the second quarter, the company anticipates revenues of approximately \$550 million, indicating a decline of nearly 23% year over year. Although volumes have improved after having bottomed in early May, it is still 8% below pre-coronavirus levels.
- ▼ Additionally, the company's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 14.6% compares unfavorably with ROE of 27.1% for its industry and 18% for the S&P 500 index, of which Kansas City Southern is a key member.

The company's second-quarter revenues are expected to decline approximately 23% year over year due to coronavirus-induced volume softness.

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

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 down 0.2% and up 24.4% 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 down 5.1% and 12.7% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 6.2% and 11.8%, respectively.

The S&P 500 index is down 1.8% in the year-to-date period and up 5.8% in the past year.

The stock is currently trading at 20.77X trailing 12-month price-to-earnings, which compares to 18.49X for the Zacks sub-industry, 16.15X for the Zacks sector and 20.39X 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 19.91X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$162 price target reflects 22.04X 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	20.77	18.49	16.15	20.39
	5-Year High	25.53	22.72	19.57	22.25
	5-Year Low	14.3	13.73	11.63	15.98
	5-Year Median	19.91	19.72	15.55	19.13
EV/EBITDA TTM	Current	11.77	12.89	7.39	11.72
	5-Year High	17.18	31.25	11.21	12.86
	5-Year Low	8.48	7.86	5.45	8.25
	5-Year Median	11.26	12.18	7.38	10.87
P/S F 12M	Current	5.16	5.44	1.23	3.51
	5-Year High	5.59	5.5	1.42	3.51
	5-Year Low	2.83	3.04	0.85	2.53
	5-Year Median	4.04	4.55	1.2	3.02

As of 07/14/2020

Industry Analysis Zacks Industry Rank: Top 42% (105 out of 251)



Top Peers

Company (Ticker)	Rec	Rank
Canadian Pacific Railway Limited (CP)	Outperform	1
Berkshire Hathaway Inc. (BRK.B)	Neutral	4
Caterpillar Inc. (CAT)	Neutral	3
Canadian National Railway Company (CNI)	Neutral	2
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	B
Market Cap	14.52 B	20.98 B	21.89 B	53.08 B	49.20 B	116.64 B
# of Analysts	8	7	14	10	10	10
Dividend Yield	1.05%	1.79%	1.86%	1.50%	2.11%	2.26%
Value Score	C	-	-	C	C	C
Cash/Price	0.01	0.05	0.07	0.05	0.01	0.01
EV/EBITDA	14.08	11.30	12.84	10.48	11.54	12.88
PEG Ratio	1.54	2.80	2.92	2.76	2.92	2.24
Price/Book (P/B)	3.05	3.21	3.06	4.46	3.31	7.29
Price/Cash Flow (P/CF)	14.14	11.92	11.89	11.59	11.92	14.67
P/E (F1)	23.17	22.37	21.54	19.53	20.38	22.37
Price/Sales (P/S)	4.97	4.48	2.27	4.51	4.44	5.41
Earnings Yield	4.38%	4.43%	4.38%	5.12%	4.91%	4.47%
Debt/Equity	0.68	0.69	0.76	1.39	0.79	1.65
Cash Flow (\$/share)	10.81	6.11	6.94	5.98	14.93	11.72
Growth Score	B	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	11.08%	11.86%	10.85%	23.43%	18.67%	12.65%
Proj. EPS Growth (F1/F0)	-2.84%	-12.22%	-9.64%	-14.87%	-15.56%	-8.29%
Curr. Cash Flow Growth	8.60%	1.21%	5.51%	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	1.03	1.30	1.73	0.90	0.82
Debt/Capital	40.39%	44.24%	44.46%	58.09%	44.24%	62.25%
Net Margin	20.11%	21.74%	10.54%	27.74%	21.89%	27.85%
Return on Equity	14.63%	16.49%	15.75%	27.27%	18.12%	34.15%
Sales/Assets	0.30	0.34	0.54	0.31	0.30	0.35
Proj. Sales Growth (F1/F0)	-6.48%	-8.61%	-2.52%	-11.34%	-13.21%	-9.30%
Momentum Score	F	-	-	C	F	B
Daily Price Chg	3.33%	2.01%	1.60%	1.02%	1.60%	1.61%
1 Week Price Chg	-2.34%	-1.64%	-0.41%	-1.92%	-2.10%	-1.59%
4 Week Price Chg	2.86%	0.54%	-0.71%	-1.45%	-0.45%	0.54%
12 Week Price Chg	16.67%	18.62%	15.18%	16.58%	18.62%	19.03%
52 Week Price Chg	24.45%	-12.84%	-6.45%	-12.84%	-13.82%	-1.86%
20 Day Average Volume	1,061,673	281,345	2,246,780	3,641,603	1,343,607	3,269,500
(F1) EPS Est 1 week change	-0.46%	0.00%	0.00%	-0.53%	-0.72%	0.04%
(F1) EPS Est 4 week change	-1.81%	-1.81%	0.00%	-1.80%	-2.26%	-0.17%
(F1) EPS Est 12 week change	-9.70%	-8.85%	-6.22%	-8.01%	-10.84%	-7.22%
(Q1) EPS Est Mthly Chg	-1.01%	-0.87%	0.00%	-1.34%	-0.82%	-0.93%

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	C
Growth Score	B
Momentum Score	F
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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