

Kansas City Southern (KSU)

\$166.52 (As of 01/17/20)

Price Target (6-12 Months): **\$177.00**

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: D

Growth: B

Momentum: D

Summary

Shares of Kansas City Southern have outperformed its industry in a year's time, mainly due to improved efficiencies. Increased efficiency, thanks to the adoption of the precision scheduled railroading model is aiding the bottom line. Improvement in adjusted operating ratio is a huge positive. Akin to the first three quarters of 2019, this key metric improved in fourth-quarter 2019. The metric is expected to be below 60% in 2021. Moreover, as the company has significant exposure to Mexico, Trump's decision to indefinitely suspend Mexico tariff plans bodes well. We are also impressed by the efforts to reward its shareholders. However, softness in Intermodal, Automotive and Energy volumes is hurting Kansas City Southern's overall volumes, that dipped 1% in 2019. The change in Mexico fuel excise tax credit is an added concern.

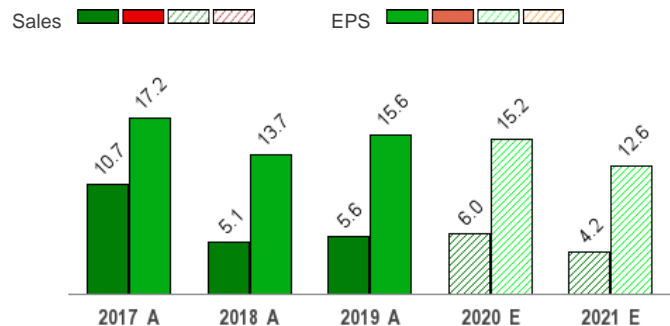
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$168.81 - \$101.11
20 Day Average Volume (sh)	981,443
Market Cap	\$16.5 B
YTD Price Change	8.7%
Beta	0.99
Dividend / Div Yld	\$1.60 / 1.0%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 12% (223 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.6%
Last Sales Surprise	-1.2%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	NA
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					3,166 E
2020	713 E	761 E	789 E	780 E	3,037 E
2019	675 A	714 A	748 A	730 A	2,866 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.99 E	\$2.28 E	\$2.48 E	\$2.45 E	\$8.95 E
2020	\$1.76 E	\$2.03 E	\$2.18 E	\$2.20 E	\$7.95 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.

P/E TTM	24.0
P/E F1	21.0
PEG F1	1.4
P/S TTM	5.8

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/17/2020. The reports text is as of 01/20/2020.

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%

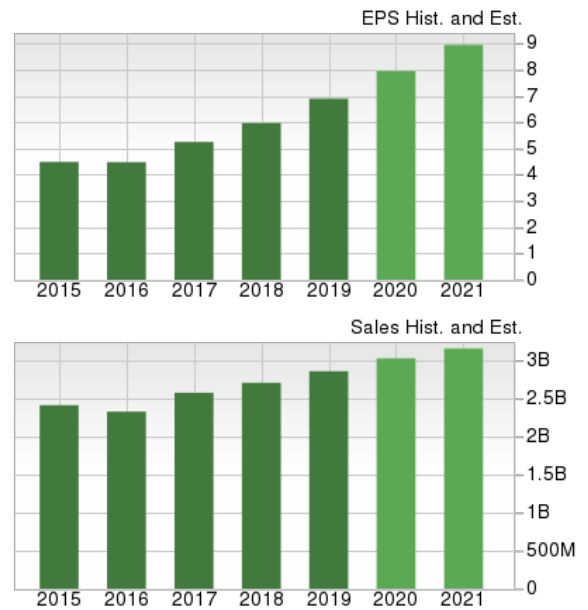
Agriculture & Minerals - 17.7%

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. We are also impressed by the company's efforts to reward its shareholders through dividend payments and buybacks. To this end, company raised the quarterly dividend payout on its common stock by 11.1% to 40 cents a share (\$1.60 annually). In another shareholder-friendly move, Kansas City Southern's board members approved a \$2-billion worth share repurchase program that expires on Dec 31, 2022. This new buyback replaces the \$800-million plan announced in 2017. Under the \$800-million scheme, the company bought shares for approximately \$741 million.
- ▲ Improvement in adjusted operating ratio (operating expenses as a percentage of revenues) in the first nine months of 2019 (90 basis points to 63.2%) is an added positive and can be attributed to the company's efforts to cut costs. Additionally, Kansas City Southern expects 2020 operating ratio in the 60-61% range. The metric is expected to be below 60% in 2021. Lower the value of this key metric, the better. Moreover, earnings per share is projected to grow at mid-teens CAGR for the 2019-2021 time frame.
- ▲ 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.

Improvement in operating ratio is a huge positive for the company. We are also impressed by the company's efforts to reward its shareholders

Reasons To Sell:

- ▼ Kansas City Southern, like other railroads in the United States, is being hurt by reduced rail freight traffic. Overall volume declined 1% in 2019 due to weaknesses in key divisions. Softness pertaining to intermodal volume (down 5% in 2019) due to a sluggish U.S. market are hurting overall rail traffic at Kansas City Southern. Automotive volume (down 4%) is being hurt by the unscheduled plant shutdown. Moreover, volume at the Energy segment is being hurt by weaknesses in the crude oil (down 20% in 2019) and frac sand (down 19%) sub-groups.
- ▼ Kansas City Southern has a significant exposure to Mexico. Consequently, the change in Mexico fuel excise tax credit effective Apr 30, 2019, which eliminates a tax credit for locomotives, is unfavorable for the company. The change has resulted in increased cost of fuel for the company in Mexico. Notably, the loss of the Mexican Fuel Excise Tax Credit hurt fourth-quarter adjusted operating ratio to the tune of roughly 90 basis points.
- ▼ Additionally, the company's trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of 13.4% compares unfavorably with ROE of 26.9% for its industry and 18.6% 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 Q4

Kansas City Southern's earnings (excluding 52 cents from non-recurring items) of \$1.82 beat the Zacks Consensus Estimate by a penny. Moreover, the bottom line improved 17% on a year-over-year basis. The year-over-year improvement resulted from a better operational performance.

Quarterly revenues of \$729.5 million, however, fell short of the Zacks Consensus Estimate of \$738.3 million. However, the top line improved 5.1% on a year-over-year basis, mainly owing to strong performances at the Chemicals and Petroleum and the Agriculture & Minerals units. Overall, carload volumes declined 1% mainly due to weakness in the Automotive and Intermodal segments.

Quarter Ending **12/2019**

Report Date	Jan 17, 2020
Sales Surprise	-1.20%
EPS Surprise	0.55%
Quarterly EPS	1.82
Annual EPS (TTM)	6.94

In the reported quarter, operating income (on a reported basis) declined roughly 8% to \$236 million. However, operating income (excluding restructuring charges pertaining to Precision Scheduled Railroading initiatives) rose 10.6% to \$274.3 million. Kansas City Southern's adjusted operating ratio (operating expenses as a percentage of revenues) improved to 62.4% from 64.3% a year ago. Lower the value of the metric the better.

Segmental Details

The Chemical & Petroleum segment generated revenues of \$186.1 million, up 13% year over year. Volumes expanded 7% year over year. Revenues per carload also climbed 6% from the prior-year quarter.

The Industrial & Consumer Products segment generated revenues of \$154.4 million, up 11% year over year. Both business volumes and revenues per carload were up 5% on a year-over-year basis.

The Agriculture & Minerals segment's total revenues decreased 3% to \$127.3 million. While business volumes were up 2%, revenues per carload declined 5% on a year-over-year basis.

The Energy segment's revenues logged \$62.7 million, down 4% year over year. Notably, the positive impact of increased Utility Coal shipments was more than negated by declines in Frac Sand and Crude Oil operations. While business volumes increased 2% year over year, revenues per carload declined 6%.

Intermodal revenues were \$97.2 million, down 1% year over year. While business volumes slipped 5%, revenues per carload increased 5% year over year.

Revenues in the Automotive segment increased 4% year over year to \$62.3 million. While business volumes fell 6%, revenues per carload climbed 11% on a year-over-year basis.

Other revenues totaled \$39.5 million, up 12% year over year.

Outlook

For 2020, volume growth is expected in low single digits. Moreover, the company anticipates mid-single digit revenue growth in 2020. Capital expenditures anticipated to be roughly 17% of revenues in the 2020-2022 period.

Additionally, Kansas City Southern expects 2020 operating ratio in the 60-61% range. The metric is expected to be below 60% in 2021. Moreover, earnings per share is projected to grow at mid-teens CAGR for the 2019-2021 time frame.

Recent News

Dividend Increased - Nov 12, 2019

The company's board of directors approved an 11.1% increase in its quarterly dividend payout on its common stock. This new dividend of 40 cents a share (\$1.60 annually) will be paid out on Jan 22, 2020, to its stockholders of record as of Dec 31, 2019.

Additionally, Kansas City Southern's board members approved a \$2-billion worth share repurchase program that expires on Dec 31, 2022. This new buyback replaces the \$800-million plan announced in 2017. Under the \$800-million scheme, the company bought shares for approximately \$741 million.

Valuation

Kansas City Southern shares are up 50.7% over the trailing 12-month period. Over the past year, the Zacks sub-industry and the sector are up 19% and 11.2%, respectively. The S&P 500 index is up 28.3% in the past year.

The stock is currently trading at 20.81X forward 12-month price-to-earnings, which compares to 18.17X for the Zacks sub-industry, 13.36X for the Zacks sector and 19.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.42X and as low as 13.21X, with a 5-year median of 17.69X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$177 price target reflects 22.11X 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 F12M	Current	20.81	18.17	13.36	19.2
	5-Year High	22.42	19.35	16.98	19.34
	5-Year Low	13.21	13.46	10.46	15.17
	5-Year Median	17.69	16.68	13.11	17.44
P/B TTM	Current	3.18	5.67	3.36	4.55
	5-Year High	3.25	5.76	4.67	4.55
	5-Year Low	1.67	2.21	2.68	2.85
	5-Year Median	2.33	4.4	3.42	3.61
P/S F12M	Current	5.42	5.53	1.16	3.57
	5-Year High	5.42	5.53	1.44	3.57
	5-Year Low	2.83	3.04	1.03	2.54
	5-Year Median	4.03	4.43	1.23	3

As of 1/17/2020

Industry Analysis Zacks Industry Rank: Bottom 12% (223 out of 254)



Top Peers

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

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	KSU Neutral	X Industry	S&P 500	CSX Neutral	NSC Neutral	UNP Neutral
VGM Score	C	-	-	D	D	D
Market Cap	16.51 B	26.27 B	24.65 B	59.77 B	54.58 B	128.65 B
# of Analysts	7	7	13	9	5	6
Dividend Yield	0.96%	1.65%	1.73%	1.26%	1.80%	2.09%
Value Score	D	-	-	D	D	D
Cash/Price	0.00	0.04	0.04	0.04	0.01	0.01
EV/EBITDA	14.03	12.71	14.11	11.67	12.71	14.04
PEG Ratio	1.40	1.98	2.08	1.44	1.99	1.96
Price/Book (P/B)	3.18	3.58	3.39	5.03	3.58	7.14
Price/Cash Flow (P/CF)	17.56	15.08	13.81	13.47	15.12	16.74
P/E (F1)	20.95	18.89	19.19	17.93	18.91	19.62
Price/Sales (P/S)	5.76	4.88	2.69	5.01	4.75	5.78
Earnings Yield	4.77%	5.30%	5.21%	5.58%	5.29%	5.09%
Debt/Equity	0.46	0.73	0.72	1.35	0.73	1.35
Cash Flow (\$/share)	9.48	5.67	6.94	5.67	13.84	11.07
Growth Score	B	-	-	B	C	C
Hist. EPS Growth (3-5 yrs)	7.95%	9.54%	10.56%	19.91%	14.51%	9.54%
Proj. EPS Growth (F1/F0)	15.24%	10.86%	7.57%	2.16%	10.28%	11.65%
Curr. Cash Flow Growth	9.74%	8.45%	14.73%	35.99%	26.47%	20.97%
Hist. Cash Flow Growth (3-5 yrs)	7.63%	6.34%	9.00%	9.35%	6.34%	5.76%
Current Ratio	0.78	0.89	1.24	1.41	0.73	0.89
Debt/Capital	31.54%	42.11%	42.99%	57.38%	42.11%	57.44%
Net Margin	20.23%	23.75%	11.14%	27.91%	23.98%	27.28%
Return on Equity	13.03%	15.63%	17.16%	27.29%	18.22%	32.65%
Sales/Assets	0.29	0.35	0.55	0.31	0.31	0.36
Proj. Sales Growth (F1/F0)	5.66%	4.51%	4.16%	0.52%	1.70%	3.03%
Momentum Score	D	-	-	F	F	F
Daily Price Chg	3.03%	0.30%	0.27%	-0.44%	1.49%	0.77%
1 Week Price Chg	1.93%	0.23%	0.39%	0.64%	0.57%	-1.68%
4 Week Price Chg	8.81%	4.41%	2.95%	5.25%	9.07%	4.42%
12 Week Price Chg	14.45%	7.45%	7.76%	6.61%	14.27%	8.76%
52 Week Price Chg	59.90%	18.61%	22.29%	17.38%	26.80%	19.84%
20 Day Average Volume	981,443	146,934	1,536,375	3,277,875	1,235,181	2,340,545
(F1) EPS Est 1 week change	0.18%	0.00%	0.00%	-0.38%	-1.04%	-0.41%
(F1) EPS Est 4 week change	-0.09%	-0.44%	0.00%	-0.79%	-1.07%	-1.22%
(F1) EPS Est 12 week change	2.65%	-2.73%	-0.40%	-2.42%	-3.41%	-3.04%
(Q1) EPS Est Mthly Chg	2.29%	1.08%	0.00%	-2.22%	1.09%	-1.66%

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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