

Norfolk Southern(NSC)

\$192.39 (As of 08/04/20)

Price Target (6-12 Months): **\$202.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 12/02/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: D

Summary

Norfolk Southern's top and the bottom line declined in second-quarter 2020 due to dwindling volumes (down 26%) as a result of the economic downturn caused by coronavirus. Revenues dropped in double-digits at all the three units, namely intermodal, coal and merchandise, thanks to volume woes. However, we are impressed by its commitment to reward its shareholders. Strong free cash flow generation at Norfolk Southern supports shareholder-friendly activities. Moreover, efforts to control costs, courtesy of the precision scheduled railroading player's operating plan, are a positive, particularly, against the backdrop of dented revenues. Notably, operating costs fell 21% in the second quarter on low fuel, compensation and benefits, and purchased services expenses. Despite cost improvements, the operating ratio deteriorated due to dismal revenues.

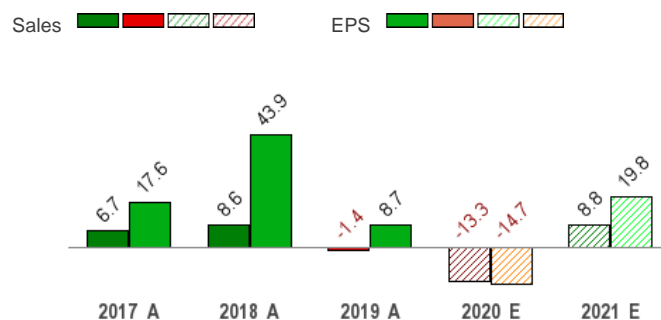
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$219.88 - \$112.62
20 Day Average Volume (sh)	1,521,762
Market Cap	\$53.0 B
YTD Price Change	-0.9%
Beta	1.38
Dividend / Div Yld	\$3.76 / 2.0%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 25% (191 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	10.1%
Last Sales Surprise	1.1%
EPS F1 Est- 4 week change	0.3%
Expected Report Date	10/28/2020
Earnings ESP	0.0%
P/E TTM	20.8
P/E F1	21.8
PEG F1	1.8
P/S TTM	5.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,623 E	2,683 E	2,678 E	2,717 E	10,652 E
2020	2,625 A	2,085 A	2,469 E	2,591 E	9,792 E
2019	2,840 A	2,925 A	2,841 A	2,690 A	11,296 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.48 E	\$2.64 E	\$2.61 E	\$2.73 E	\$10.57 E
2020	\$2.58 A	\$1.53 A	\$2.19 E	\$2.44 E	\$8.82 E
2019	\$2.51 A	\$2.70 A	\$2.58 A	\$2.55 A	\$10.34 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 08/04/2020. The reports text is as of 08/05/2020.

Overview

Norfolk Southern Corporation, incorporated on Jul 23, 1980, under the laws of the Commonwealth of Virginia, controls a major freight railroad, Norfolk Southern Railway Company. The company is primarily engaged in the rail transportation of raw material, intermediate products and finished goods, primarily in Southeast, East and Midwest United States and, via interchange with rail carriers to and from the rest of country.

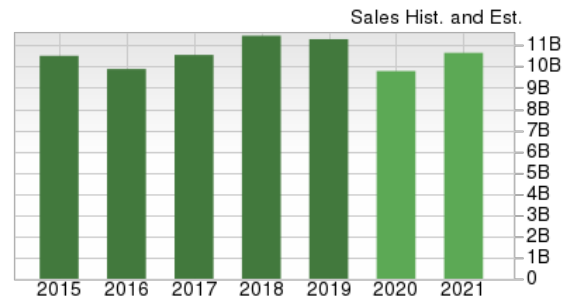
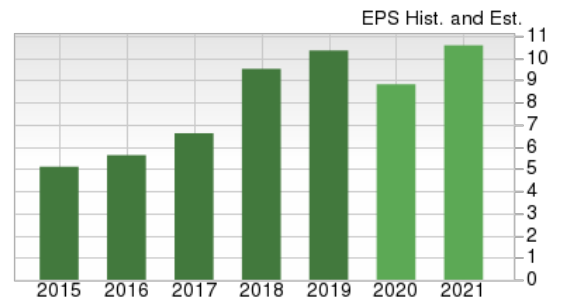
Norfolk Southern also transports overseas freight through several Atlantic and Gulf Coast ports. Norfolk Southern provides comprehensive logistics services and offers the most extensive intermodal network on the eastern side of the United States.

The company's fiscal year coincides with the calendar year. At 2019-end, the company was responsible for operating approximately 19,500 route miles in 22 states and the District of Columbia.

The company, currently headquartered in Norfolk, VA, announced in December 2018, that it will shift headquarters to Atlanta. The move is likely to be completed by Dec 31, 2021.

Norfolk Southern derives freight revenues from transporting coal, general merchandise and intermodal (truck, rail and ship) containers:

- **Coal** business includes transportation of utility coal, export coal and domestic metallurgical coal from mines to electricity generating plants. The sector accounted for 14.8% of 2019 revenues.
- **General Merchandise** business includes transportation of automotive, chemicals, metals and construction, agriculture, consumer products, and paper, clay and forest products (lumber and wood). Chemicals include sulfur and related chemicals, petroleum products. Agriculture, consumer products, and government includes soybeans, wheat, corn, fertilizer, livestock. Metals and construction includes steel, aluminum products, machinery, scrap metals, cement, aggregates, sand, and minerals. The sector accounted for 60.2% of the 2019 revenues recorded by the company.
- The **Intermodal** segment is responsible for haulage of international container cargo from steamship companies and truckload carriers. The sector accounted for 25% of the 2019 revenues recorded by the company.



Reasons To Buy:

- ▲ Although, Norfolk Southern has decided to take a conservative approach to share repurchases going forward due to the coronavirus-related adversities, the fact that the company is still committed to rewarding its shareholders through dividends is noteworthy. In first-half 2020, the company returned \$1,151 million to shareholders through a combination of dividends (\$482 million) and share buybacks (\$669 million). Such shareholder-friendly measures can be attributed to its strong free cash flow generation capabilities. During the first half, Norfolk Southern generated free cash flow of \$1,023 million, up 5% year over year.
- ▲ Norfolk Southern is making constant efforts to streamline its operations by curbing costs. In line with its endeavors to improve efficiencies, Norfolk Southern's operating ratio (operating expenses as a percentage of revenues) in 2019 improved to 64.7% from 65.4% a year ago. Notably, lower the value of the metric the better. Notably, Norfolk Southern's precision scheduled railroading operating plan, TOP21, aims to enhance efficiency and customer service. The first phase of the recently implemented program already reaped multiple benefits. Following this implementation, network efficiency of the merchandise unit improved greatly owing to reduced circuitry, train miles and train start.
- ▲ Amid the current scenario of dwindling revenues, low fuel costs (down 46% in first-half 2020) are providing providing cushion to the bottom-line. Notably, operating expenses declined 16% in first-half 2020. Moreover, the company's improving cash position is encouraging. The company exited the second quarter of 2020 with cash and cash equivalents of \$1,143 million compared with \$580 million at the end of 2019.

We are impressed by the company's focus on rewarding shareholders despite adversities.

Reasons To Sell:

- ▼ Norfolk Southern anticipates the adversities from the coronavirus pandemic to affect its performance significantly in second-half 2020 too. The company expects volumes to decline across all segments. Consequently, the company estimates current-year results to be substantially impacted from the global health peril. The company has withdrawn its guidance for revenues and operating ratio for 2020 considering the uncertainty surrounding the coronavirus pandemic.
- ▼ Apart from the coronavirus-related headwind, coal segment weakness due to low natural gas prices and unfavorable weather conditions is worrisome. Continued low natural gas prices and unfavorable crude oil spreads are denting its energy markets. The company anticipates geopolitical tensions as well as coronavirus to continue to hurt export coal.
- ▼ The company has been hit by the coronavirus outbreak primarily since February. Notably, overall volumes declined 19% in first-half 2020 with volumes declining 17%, 13% and 44%, in the three reportable segments, merchandise, intermodal and coal, respectively. Declining revenues at the key segments due to dismal volumes are likely to persist in the coming quarters too.

Low volumes due to coronavirus are anticipated to dent the company's performance going forward too.

Last Earnings Report

Earnings Beat at Norfolk Southern in Q2

Norfolk Southern's earnings of \$1.53 per share surpassed the Zacks Consensus Estimate of \$1.39. However, the bottom line plunged 43% on a year-over-year basis. Railway operating revenues in the quarter under review came in at \$2,085 million, edging past the Zacks Consensus Estimate of \$2,061.5 million. The top line however declined 29% year over year due to 26% drop in total volumes as a result of the economic downturn caused by coronavirus.

Income from railway operations plunged 43% year over year to \$610 million. Operating expenses declined 21% on a year-over-year basis to \$1,475 million, thanks to low fuel, compensation and benefits, and purchased services expenses. Norfolk Southern's operating ratio (operating expenses as a percentage of revenues) in the second quarter deteriorated to 70.7% from 63.6% in the year-ago period. With respect to this metric, lower the value, the better.

Segmental Performance

On a year-over-year basis, coal revenues totaled \$209 million, down 55% year over year. Coal volumes contracted 57%. However, revenue per unit inched up 3% in the reported quarter.

Merchandise revenues declined 26% to \$1,307 million and volumes fell 29%. Revenue per unit improved 5% for the segment.

Intermodal revenues declined 19% year over year to \$569 million. Segmental volumes also decreased 16%. Revenue per unit slipped 4% on a year-over-year basis.

Liquidity & Share Buyback

The company exited the second quarter with cash and cash equivalents of \$1,143 million compared with \$580 million at the end of 2019. The company had long-term debt of \$12,612 million at the end of the reported quarter compared with \$11,880 million at 2019-end.

During the first six months of 2020, Norfolk Southern repurchased and retired 3.9 million shares at a cost of \$669 million.

Quarter Ending **06/2020**

Report Date	Jul 29, 2020
Sales Surprise	1.14%
EPS Surprise	10.07%
Quarterly EPS	1.53
Annual EPS (TTM)	9.24

Recent News

Dividend Update — Jul 28, 2020

The company's board cleared a quarterly cash dividend of 94 cents per share, payable to shareholders on Sep 10 of record as of Aug 7. It paid out dividends for 152 consecutive quarters.

Valuation

Norfolk Southern shares are down 0.9% in the year-to-date period but up 6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Transportation sector are down 0.1% and 7% in the year-to-date period respectively. Over the past year, the Zacks sub-industry is up 6.8% and the sector is down 0.9%.

The S&P 500 index is up 2.3% in the year-to-date period and 14.6% in the past year.

The stock is currently trading at 20.82X trailing 12-month price-to-earnings, which compares to 19.31X for the Zacks sub-industry, 17.21X for the Zacks sector and 23.3X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.72X and as low as 11.5X, with a 5-year median of 19X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$202 price target reflects 21.86X trailing 12-month earnings.

The table below shows summary valuation data for NSC

Valuation Multiples - NSC					
		Stock	Sub-Industry	Sector	S&P 500
P/ETTM	Current	20.82	19.31	17.21	23.3
	5-Year High	23.72	20.85	19.57	23.3
	5-Year Low	11.5	11.51	11.63	15.98
	5-Year Median	19	17.32	15.58	19.2
EV/EBITDA TTM	Current	14.03	10.94	7.81	12.76
	5-Year High	48.23	12.98	11.22	12.85
	5-Year Low	7.09	6.76	5.47	8.24
	5-Year Median	11.14	9.44	7.39	10.89
P/S F 12M	Current	5.16	1.24	1.32	3.6
	5-Year High	5.23	1.5	1.42	3.6
	5-Year Low	1.91	0.84	0.85	2.53
	5-Year Median	3.55	1.19	1.2	3.04

As of 08/04/2020

Industry Analysis Zacks Industry Rank: Bottom 25% (191 out of 254)



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
Kansas City Southern (KSU)	Neutral	3
Union Pacific Corporation (UNP)	Neutral	3
WEST JAPAN RAIL (WJRY)	Neutral	4

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	NSC	X Industry	S&P 500	CNI	CSX	UNP
Zacks Recommendation (Long Term)	Neutral	-	-	Outperform	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	2	3	3
VGM Score	C	-	-	D	C	C
Market Cap	52.99 B	20.74 B	22.75 B	69.28 B	54.14 B	117.90 B
# of Analysts	10	7	14	10	10	10
Dividend Yield	1.95%	1.69%	1.76%	1.69%	1.47%	2.23%
Value Score	B	-	-	C	B	B
Cash/Price	0.02	0.05	0.07	0.01	0.05	0.02
EV/EBITDA	12.32	12.18	13.09	13.76	10.57	12.86
PEG Ratio	1.81	2.65	2.95	3.53	2.65	2.25
Price/Book (P/B)	3.57	3.51	3.16	5.11	4.45	7.17
Price/Cash Flow (P/CF)	12.89	12.89	12.32	15.95	11.83	14.82
P/E (F1)	21.81	22.48	21.81	24.62	20.14	22.48
Price/Sales (P/S)	5.17	5.05	2.46	6.55	4.93	5.84
Earnings Yield	4.58%	4.26%	4.40%	4.07%	4.96%	4.44%
Debt/Equity	0.85	0.81	0.76	0.70	1.33	1.61
Cash Flow (\$/share)	14.93	6.11	6.94	6.11	5.98	11.72
Growth Score	D	-	-	D	D	C
Hist. EPS Growth (3-5 yrs)	18.89%	12.62%	10.46%	6.34%	23.81%	13.50%
Proj. EPS Growth (F1/F0)	-14.74%	-11.20%	-7.16%	-9.89%	-15.73%	-7.82%
Curr. Cash Flow Growth	3.26%	1.21%	5.47%	6.26%	0.86%	-0.27%
Hist. Cash Flow Growth (3-5 yrs)	5.66%	5.61%	8.55%	3.06%	8.74%	2.78%
Current Ratio	1.21	1.08	1.32	0.97	1.62	0.96
Debt/Capital	45.91%	45.91%	44.36%	41.11%	57.01%	61.64%
Net Margin	20.47%	20.55%	10.25%	25.66%	26.39%	27.54%
Return on Equity	16.06%	15.46%	14.67%	20.92%	24.24%	32.45%
Sales/Assets	0.27	0.32	0.51	0.32	0.28	0.32
Proj. Sales Growth (F1/F0)	-13.31%	-8.54%	-1.71%	-8.54%	-12.15%	-11.40%
Momentum Score	D	-	-	F	D	C
Daily Price Chg	1.01%	1.03%	0.42%	0.55%	0.58%	0.94%
1 Week Price Chg	2.78%	-0.15%	0.14%	1.34%	0.00%	-1.57%
4 Week Price Chg	10.49%	8.36%	4.97%	10.43%	3.27%	2.30%
12 Week Price Chg	15.35%	15.35%	15.30%	19.64%	10.29%	12.79%
52 Week Price Chg	6.08%	6.08%	2.34%	6.17%	6.42%	3.18%
20 Day Average Volume	1,521,762	280,598	2,082,836	1,065,900	3,582,544	3,018,085
(F1) EPS Est 1 week change	2.20%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.25%	0.13%	0.93%	1.70%	-1.54%	0.56%
(F1) EPS Est 12 week change	-3.10%	-2.29%	0.78%	3.69%	-3.01%	0.21%
(Q1) EPS Est Mthly Chg	0.49%	1.20%	0.17%	1.92%	2.04%	-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	D
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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