

Norfolk Southern(NSC)

\$209.17 (As of 02/11/20)

Price Target (6-12 Months): **\$222.00**

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: D

Growth: B

Momentum: C

Summary

Akin to the first three quarters of 2019, Norfolk Southern's fourth-quarter 2019 results were dented by low volumes, which declined 9%, thereby causing the bottom line to contract year over year. Volumes suffered in the December-end quarter due to factors like excess truck capacity, trade and economic uncertainty. The company's high-debt levels are worrisome as well. However, the company's measures to reward its shareholders through dividends and buybacks are encouraging. Moreover, in a bid to combat declining revenues (down 7.1% in fourth-quarter 2019), Norfolk Southern is looking to cut costs to boost its bottom line. Backed by cost-cut efforts, operating ratio has been improving for the last few quarters. Mainly due to these tailwinds, shares of the company have outperformed its industry in a year's time.

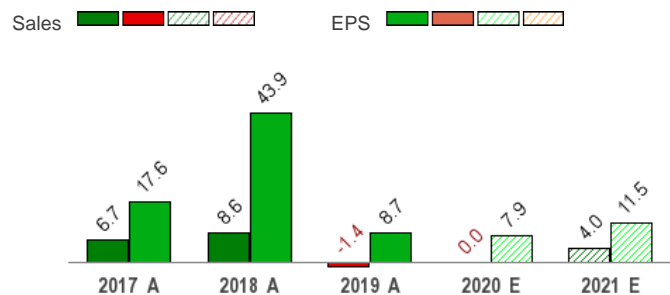
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$219.88 - \$166.57
20 Day Average Volume (sh)	1,700,996
Market Cap	\$53.9 B
YTD Price Change	7.8%
Beta	1.34
Dividend / Div Yld	\$3.76 / 1.8%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 35% (166 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	11.4%
Last Sales Surprise	-0.0%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	04/22/2020
Earnings ESP	-0.1%
P/E TTM	20.2
P/E F1	18.7
PEG F1	1.6
P/S TTM	4.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,812 E	3,030 E	3,026 E	2,950 E	11,746 E
2020	2,655 E	2,865 E	2,924 E	2,848 E	11,293 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	\$2.77 E	\$3.26 E	\$3.20 E	\$3.08 E	\$12.44 E
2020	\$2.41 E	\$2.90 E	\$2.96 E	\$2.77 E	\$11.16 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 02/11/2020. The reports text is as of 02/12/2020.

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.

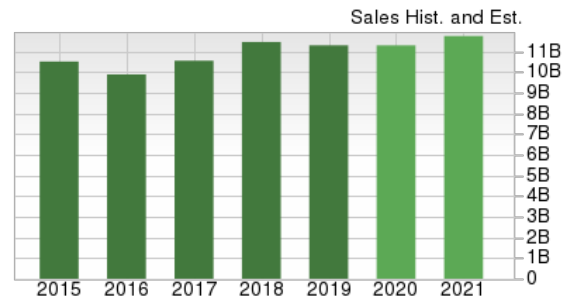
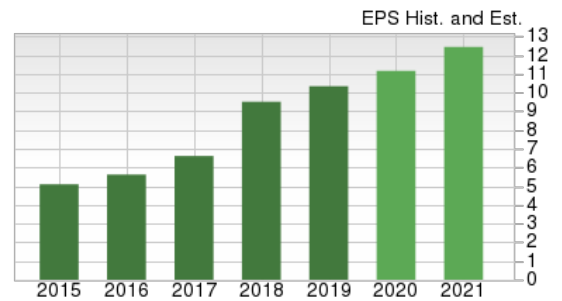
Norfolk Southern also transports overseas freight through several Atlantic and Gulf Coast ports. Norfolk Southern provides comprehensive logistics services and offers the most extensive intermodal network on the eastern side of the United States.

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:

- ▲ We are impressed by the company's focus on rewarding shareholders through share repurchases and dividends. Norfolk Southern returned more than \$3.6 billion in 2018 through dividends (\$844 million) and buybacks (\$2,781 million). In 2019, the company returned \$3,048 million to its shareholders through dividends (\$949 million) and buybacks (\$2,099 million). Notably, Norfolk Southern has hiked its quarterly dividend payout four times since 2018. Free cash flow of \$1,873 million was generated in 2019, reflecting a 6% year-over-year increase. Robust free cash-flow generation by the company supports the possibility of a dividend raise in the days to come.
- ▲ 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. Further improvement in the ratio is expected in 2020. The company is aimed at achieving an operating ratio of 60% in 2021.
- ▲ Norfolk Southern's new 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. In fact, phase 3 of the program is being rolled out currently.

Improvement in operating ratio is a major tailwind for the company. We are also impressed by the company's focus on rewarding shareholders through share repurchases and dividends.

Reasons To Sell:

- ▼ Norfolk Southern's automotive sub-group (part of its merchandise division) has been performing disappointingly for quite some time and the situation is unlikely to improve dramatically in the near future. Automotive volumes shrunk 2% in 2019, due to decelerating vehicle production in the United States. Apart from the automotive sub-group, key components of the merchandise segment like forest and consumer (volumes down 7% in 2019) plus metals and construction (volumes down 5% in 2019) performed dismally. With key sub-groups performing badly, volumes at the merchandise segment slid 3% in 2019.
- ▼ Apart from the merchandise segment, key units like coal and intermodal put up a poor show, mainly due to below-par rail traffic volumes. In 2019, intermodal volumes at Norfolk Southern declined 4% while coal volumes shrank 12%. Due to the sluggish performance of its key divisions, overall volumes declined 5% in 2019. We expect Norfolk Southern's overall volumes to be weak in the near term. Due to the lackluster freight scenario, first-quarter 2020 revenues are expected to be similar to what was achieved in fourth-quarter 2019.
- ▼ We are also concerned about the company's high-debt levels. At the end of 2019, the company's long-term debt increased to \$11,880 million from 10,560 million at the end of 2018. Apart from a rise in immediate finance costs, the high-debt level will require significant cash flows for repayments.

The company's high debt levels raise concerns. Sluggish overall volumes are worrisome too.

Last Earnings Report

Earnings Beat at Norfolk Southern in Q4

The company's earnings of \$2.55 per share surpassed the Zacks Consensus Estimate of \$2.29. However, the bottom line dipped nearly 1% on a year-over-year basis due to low volumes.

Railway operating revenues in the quarter under review came in at \$2,690 million, marginally missing the Zacks Consensus Estimate of \$2,690.3 million. The top line also declined 7.1% year over year due to disappointing revenues at the merchandise, coal and intermodal units. Overall volumes decreased 9%.

Income from railway operations declined 11% year over year to \$962 million. Operating expenses fell 5% on a year-over-year basis to \$1,728 million, primarily owing to lower fuel costs as well as expenses related to compensation and benefits. Norfolk Southern's operating ratio (operating expenses as a percentage of revenues) in the fourth quarter deteriorated 140 basis points to 64.2%. Notably, lower the value of the metric the better.

Segmental Performance

On a year-over-year basis, coal revenues totaled \$363 million, down 21% year over year. Coal volumes contracted 21%. Revenue per unit inched up 1% in the reported quarter.

Merchandise revenues dipped 3% to \$1,630 million. Segmental volumes fell 6%. Revenue per unit improved 3% for the segment.

Intermodal revenues decreased 8% year over year to \$697 million. Segmental volumes also declined 8%. Revenue per unit was unaltered on a year-over-year basis.

Liquidity & Share Buyback

The company exited the fourth quarter with cash and cash equivalents of \$580 million compared with \$358 million at the end of 2018. The company had long-term debt of \$11,880 million compared with \$10,560 million as of Dec 31, 2018.

Quarter Ending **12/2019**

Report Date	Jan 29, 2020
Sales Surprise	-0.01%
EPS Surprise	11.35%
Quarterly EPS	2.55
Annual EPS (TTM)	10.34

Recent News

Dividend Update - Jan 28 , 2020

The company's board approved its quarterly dividend payout of 94 cents per share. The amount will be paid on Mar 10 to shareholders of record on Feb 7. Notably, the company has paid dividends for 150 consecutive quarters.

Valuation

Norfolk Southern shares are up 15.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Transportation sector are up 14.6% and 2%, respectively, over the past year. The S&P 500 index is up 20.9% in the past year.

The stock is currently trading at 18.5X forward 12-month price-to-earnings, which compares to 18.25X for the Zacks sub-industry, 13.14X for the Zacks sector and 19.3X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.76X and as low as 11.87X, with a 5-year median of 16.66X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$222 price target reflects 19.63X forward 12-month earnings.

The table below shows summary valuation data for NSC

Valuation Multiples - NSC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.5	18.25	13.14	19.3
	5-Year High	22.76	19.35	17	19.34
	5-Year Low	11.87	13.46	10.48	15.18
	5-Year Median	16.66	16.66	13.16	17.47
EV/EBITDA TTM	Current	12.87	14.02	7.83	11.36
	5-Year High	48.23	31.25	11.09	12.85
	5-Year Low	7.31	7.98	6.01	8.49
	5-Year Median	10.94	11.93	7.41	10.7
P/S F12M	Current	4.75	5.55	1.13	3.56
	5-Year High	4.91	5.55	1.44	3.56
	5-Year Low	1.91	3.04	1.02	2.54
	5-Year Median	3.4	4.43	1.21	3

As of 02/11/2020

Industry Analysis Zacks Industry Rank: Bottom 35% (166 out of 254)



Top Peers

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

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	NSC Neutral	X Industry	S&P 500	CNI Neutral	CSX Underperform	UNP Neutral
VGM Score	C	-	-	F	D	D
Market Cap	53.93 B	37.01 B	24.17 B	67.35 B	61.43 B	126.52 B
# of Analysts	9	6	13	10	9	9
Dividend Yield	1.80%	1.69%	1.77%	1.72%	1.22%	2.12%
Value Score	D	-	-	D	D	D
Cash/Price	0.01	0.03	0.04	0.01	0.03	0.01
EV/EBITDA	12.46	12.13	13.89	13.37	11.79	13.58
PEG Ratio	1.56	1.93	2.05	1.93	1.46	1.98
Price/Book (P/B)	3.59	3.59	3.27	4.95	5.18	7.02
Price/Cash Flow (P/CF)	14.01	14.01	13.60	15.48	13.13	15.64
P/E (F1)	18.74	19.09	19.00	20.11	18.70	19.80
Price/Sales (P/S)	4.77	4.96	2.66	5.99	5.15	5.83
Earnings Yield	5.34%	5.24%	5.26%	4.97%	5.35%	5.05%
Debt/Equity	0.78	0.78	0.71	0.66	1.35	1.32
Cash Flow (\$/share)	14.93	6.09	6.89	6.09	5.98	11.72
Growth Score	B	-	-	D	B	C
Hist. EPS Growth (3-5 yrs)	16.82%	10.99%	10.85%	6.49%	21.86%	11.06%
Proj. EPS Growth (F1/F0)	7.94%	9.93%	7.22%	6.83%	0.67%	10.49%
Curr. Cash Flow Growth	3.26%	2.96%	8.88%	6.26%	0.86%	-0.27%
Hist. Cash Flow Growth (3-5 yrs)	5.66%	5.61%	8.36%	3.06%	8.74%	2.78%
Current Ratio	0.90	0.93	1.22	0.66	1.52	0.79
Debt/Capital	43.90%	43.90%	42.90%	39.68%	57.41%	56.91%
Net Margin	24.10%	23.84%	11.81%	28.25%	27.91%	27.27%
Return on Equity	18.04%	15.87%	16.98%	23.28%	27.49%	32.86%
Sales/Assets	0.30	0.35	0.54	0.34	0.31	0.35
Proj. Sales Growth (F1/F0)	-0.02%	3.83%	4.06%	5.29%	-0.91%	2.20%
Momentum Score	C	-	-	D	D	F
Daily Price Chg	-0.04%	-0.02%	0.45%	-0.16%	-0.46%	-0.74%
1 Week Price Chg	0.95%	0.85%	2.47%	0.85%	2.00%	2.46%
4 Week Price Chg	3.70%	1.46%	0.95%	0.24%	5.17%	1.38%
12 Week Price Chg	8.60%	3.46%	5.05%	2.02%	10.58%	3.46%
52 Week Price Chg	15.81%	15.60%	16.18%	15.60%	10.40%	9.73%
20 Day Average Volume	1,700,996	745,456	1,999,386	876,882	4,058,848	2,805,824
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.21%	-0.83%	0.00%	-2.13%	-3.72%	-2.36%
(F1) EPS Est 12 week change	-1.30%	-1.92%	-0.18%	-7.46%	-5.50%	-3.97%
(Q1) EPS Est Mthly Chg	-2.56%	-3.76%	0.00%	-8.66%	-5.69%	-4.66%

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	C
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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