

Norfolk Southern(NSC)

\$181.28 (As of 07/15/20)

Price Target (6-12 Months): **\$192.00**

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: C

Growth: C

Momentum: D

Summary

We expect Norfolk Southern's second-quarter 2020 results, scheduled to be released on Jul 29, to be affected severely by low volumes in these coronavirus-ravaged times. Performance of all three primary segments, namely coal, merchandise and intermodal is likely to have been dented due to volume weakness. The drop in overall volumes is likely to have dragged down second-quarter revenues, significantly. However, we are impressed by the company's commitment to reward its shareholders through dividends despite the challenging scenario (it suspended share buybacks). Moreover, efforts to control costs, courtesy of the precision scheduled railroading operating plan, are a positive, particularly, against the backdrop of revenue woes. Operating ratio is also likely to have improved in the June quarter, mainly owing to cost-cutting measures.

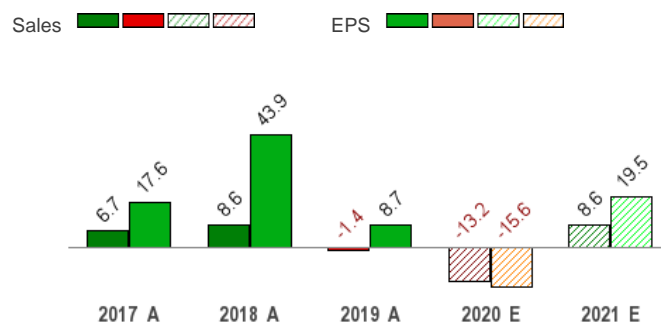
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$219.88 - \$112.62
20 Day Average Volume (sh)	1,356,138
Market Cap	\$50.1 B
YTD Price Change	-6.6%
Beta	1.37
Dividend / Div Yld	\$3.76 / 2.1%
Industry	Transportation - Rail
Zacks Industry Rank	Top 42% (105 out of 251)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	17.8%
Last Sales Surprise	2.6%
EPS F1 Est- 4 week change	-2.3%
Expected Report Date	07/29/2020
Earnings ESP	-6.1%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,714 E	2,772 E	2,738 E	2,693 E	10,650 E
2020	2,625 A	2,110 E	2,463 E	2,597 E	9,804 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	\$2.58 E	\$2.60 E	\$2.64 E	\$2.64 E	\$10.43 E
2020	\$2.58 A	\$1.51 E	\$2.18 E	\$2.41 E	\$8.73 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.

P/E TTM	17.4
P/E F1	20.8
PEG F1	1.7
P/S TTM	4.5

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/15/2020. The reports text is as of 07/16/2020.

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.

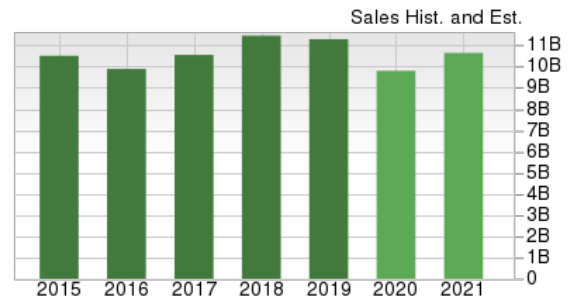
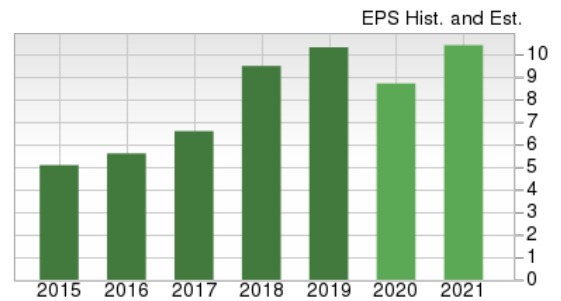
Norfolk Southern also transports overseas freight through several Atlantic and Gulf Coast ports. Norfolk Southern provides comprehensive logistics services and offers the most extensive intermodal network on the eastern side of the United States.

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. During the first quarter, the company returned \$708 million to shareholders through a combination of dividends and share buybacks. Such shareholder-friendly measures can be attributed to its strong free cash flow generation capabilities. During the first quarter, Norfolk Southern generated free cash flow of \$589 million, up 42% year over year. Coming back to the shareholder friendly activities, the company returned \$3,048 million to its shareholders through dividends (\$949 million) and buybacks (\$2,099 million). Additionally, 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.
- ▲ 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. During the first quarter, this key metric improved 230 basis to 63.7%. Operating ratio is likely to have improved in the June quarter as well mainly owing to cost-cutting measures. 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. In fact, phase 3 of the program is being rolled out currently.
- ▲ Norfolk Southern exited the March quarter with cash and cash equivalents worth \$608 million, higher than its current debt obligation of \$400 million. This implies that the company has enough liquidity to service its current debt load. Additionally, the total-debt-to-total-capital ratio, which is an indicator of the company's leverage, stood at 0.45 at the end of first-quarter 2020, comparing favorably with its industry's average of 0.53. A lower debt-to-capital ratio suggests that the proportion of debt to finance the company's assets is not on the rise.

Improvement in operating ratio is a major tailwind for the company. We are also 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 second quarter performance significantly. 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. The company anticipates lower seaborne coal prices as well as coronavirus to continue to hurt export coal.
- ▼ The company has been hurt by the coronavirus outbreak primarily since February. Notably, intermodal revenues declined 9% year over year in the first quarter, due to decrease in international intermodal volumes from the coronavirus pandemic and excess truck capacity. Moreover, plant shutdowns due to coronavirus are weighing on automotive volumes. Reduced consumer spending and supply chain disruptions are expected to continue affecting automotive intermodal and other consumer-driven products.

Low volumes due to coronavirus are anticipated to have dented the company's second-quarter performance significantly.

Last Earnings Report

Earnings Beat at Norfolk Southern in Q1

Norfolk Southern's first-quarter 2020 earnings of \$2.58 per share (excluding \$1.11 from non-recurring items) surpassed the Zacks Consensus Estimate of \$2.19. Moreover, the bottom line inched up 2.8% on a year-over-year basis.

Railway operating revenues in the quarter under review came in at \$2,625 million, edging past the Zacks Consensus Estimate of \$2,558 million. The top line however declined 7.8% year over year due to an 11% drop in total volumes owing to weak energy prices and the COVID-19 pandemic.

Income from railway operations plunged 41.2% year over year to \$568 million. Operating expenses increased 9.8% on a year-over-year basis to \$2,057 million. Norfolk Southern's adjusted operating ratio (operating expenses as a percentage of revenues) in the first quarter improved 230 basis to 63.7%. With respect to this metric, the lower the value, the better.

Segmental Performance

On a year-over-year basis, coal revenues totaled \$298 million, down 31.5% year over year. Coal volumes contracted 31%. Revenue per unit dropped 1% in the reported quarter.

Merchandise revenues declined 0.8% to \$1,672 million and volumes fell 5%. Revenue per unit improved 4% for the segment.

Intermodal revenues reduced 8.9% year over year to \$655 million. Segmental volumes also declined 11%. Revenue per unit rose 2% on a year-over-year basis.

Liquidity & Share Buyback

The company exited the first quarter with cash and cash equivalents of \$608 million compared with \$580 million at the end of 2019. The company had long-term debt of \$11,807 million compared with \$11,880 million at 2019-end.

Dividend Update

The company's board cleared a quarterly cash dividend of 94 cents per share, payable to shareholders on Jun 10 of record as of May 8. It paid out dividends for 151 consecutive quarters.

Outlook

Norfolk Southern's volumes have declined 30% quarter-to-date. Consequently, revenues are anticipated to quite low in the second quarter.

The company has withdrawn its guidance for revenues and operating ratio for 2020 considering the uncertainty surrounding the coronavirus pandemic.

Quarter Ending **03/2020**

Report Date	Apr 29, 2020
Sales Surprise	2.62%
EPS Surprise	17.81%
Quarterly EPS	2.58
Annual EPS (TTM)	10.41

Recent News

Leadership & Organizational Changes — Jun 1, 2020

John Scheib has stepped down as executive vice president and chief strategy officer. As a result, the Strategic Planning Department operates within the Finance division under the leadership of Mark George, executive vice president and chief financial officer. The Network Planning and Optimization Department, which developed and implemented the TOP21 operating plan, is now a part of the Operations division. Further, the Customer Operations Department has become a part of the Marketing division under the leadership of Alan Shaw, executive vice president and chief marketing officer. The move is aimed at promoting customer interactions to serve them in a better manner.

Valuation

Norfolk Southern shares are down 6.6% and 5.1% 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 1.7% and 9% in the year-to-date period respectively. Over the past year, the Zacks sub-industry is up 3.1% and the sector is down 4.7%.

The S&P 500 index is down 0.5% in the year-to-date period but up 7.8% and in the past year.

The stock is currently trading at 18.7X forward 12-month price-to-earnings, which compares to 19.08X for the Zacks sub-industry, 33.47X for the Zacks sector and 22.72X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.76X and as low as 10.63X, with a 5-year median of 16.92X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$192 price target reflects 19.81X 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	18.7	19.08	33.47	22.72
	5-Year High	22.76	19.35	35.19	22.72
	5-Year Low	10.63	13.46	10.48	15.25
	5-Year Median	16.92	16.8	13.35	17.52
EV/EBITDA TTM	Current	12.2	13.26	7.62	11.88
	5-Year High	48.23	31.25	11.21	12.86
	5-Year Low	7.09	7.86	5.45	8.25
	5-Year Median	11.11	12.18	7.38	10.87
P/S F 12M	Current	4.89	5.63	1.29	3.55
	5-Year High	5.23	5.63	1.42	3.55
	5-Year Low	1.91	3.04	0.85	2.53
	5-Year Median	3.54	4.55	1.2	3.02

As of 07/15/2020

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
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	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	2	3	3
VGM Score	C	-	-	B	C	C
Market Cap	50.12 B	21.49 B	22.66 B	66.33 B	54.09 B	118.34 B
# of Analysts	10	7	14	10	10	10
Dividend Yield	2.07%	1.76%	1.83%	1.76%	1.47%	2.22%
Value Score	C	-	-	C	C	C
Cash/Price	0.01	0.05	0.07	0.01	0.05	0.01
EV/EBITDA	11.72	11.60	12.99	13.27	10.63	13.03
PEG Ratio	1.72	2.84	2.97	3.47	2.82	2.26
Price/Book (P/B)	3.37	3.29	3.12	4.72	4.55	7.40
Price/Cash Flow (P/CF)	12.14	12.14	12.14	15.27	11.81	14.88
P/E (F1)	20.77	22.55	22.04	23.79	19.92	22.55
Price/Sales (P/S)	4.52	4.56	2.38	5.91	4.59	5.49
Earnings Yield	4.82%	4.37%	4.32%	4.20%	5.02%	4.43%
Debt/Equity	0.79	0.69	0.76	0.69	1.39	1.65
Cash Flow (\$/share)	14.93	6.11	6.94	6.11	5.98	11.72
Growth Score	C	-	-	B	C	C
Hist. EPS Growth (3-5 yrs)	18.67%	11.86%	10.85%	6.78%	23.43%	12.65%
Proj. EPS Growth (F1/F0)	-15.56%	-12.02%	-9.64%	-10.68%	-14.92%	-7.72%
Curr. Cash Flow Growth	3.26%	1.21%	5.51%	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	0.90	1.03	1.30	0.76	1.73	0.82
Debt/Capital	44.24%	44.24%	44.46%	40.96%	58.09%	62.25%
Net Margin	21.89%	21.74%	10.59%	29.76%	27.74%	27.85%
Return on Equity	18.12%	16.49%	15.75%	22.99%	27.27%	34.15%
Sales/Assets	0.30	0.34	0.54	0.34	0.31	0.35
Proj. Sales Growth (F1/F0)	-13.21%	-8.61%	-2.52%	-8.61%	-11.44%	-9.30%
Momentum Score	D	-	-	A	F	D
Daily Price Chg	1.88%	1.72%	1.91%	1.61%	1.90%	1.45%
1 Week Price Chg	-2.10%	-1.64%	-0.41%	1.23%	-1.92%	-1.59%
4 Week Price Chg	2.44%	2.44%	1.88%	3.58%	1.09%	1.88%
12 Week Price Chg	17.88%	17.88%	16.37%	21.35%	16.05%	18.55%
52 Week Price Chg	-5.10%	-1.01%	-4.22%	0.69%	-1.01%	5.98%
20 Day Average Volume	1,356,138	277,026	2,266,132	757,762	3,708,499	3,220,960
(F1) EPS Est 1 week change	-0.72%	0.00%	0.00%	0.72%	-0.59%	0.66%
(F1) EPS Est 4 week change	-2.26%	0.00%	0.00%	1.86%	-1.85%	0.45%
(F1) EPS Est 12 week change	-10.84%	-8.88%	-5.76%	-3.80%	-8.06%	-6.64%
(Q1) EPS Est Mthly Chg	-1.00%	-1.00%	0.00%	3.49%	-2.23%	-1.23%

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	C
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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