

Norfolk Southern(NSC)

\$209.32 (As of 01/17/20)

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:D

Value: D

Growth: C

Momentum: F

Summary

Akin to the first three quarters of 2019, we expect Norfolk Southern's fourth-quarter overall volumes to reflect year-over-year decline. Detailed results are scheduled to be released on Jan 29. Factors like slowdown in global trade and unfavorable pricing are hurting performances at key units like Coal and Intermodal, thereby dragging down overall volumes and revenues. 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, Norfolk Southern is looking to cut costs to drive 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.

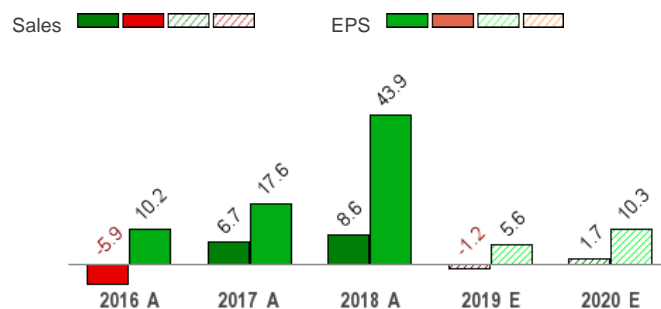
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$211.46 - \$160.19
20 Day Average Volume (sh)	1,235,181
Market Cap	\$54.6 B
YTD Price Change	7.8%
Beta	1.36
Dividend / Div Yld	\$3.76 / 1.8%
Industry	Transportation - Rail
Zacks Industry Rank	Bottom 12% (223 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.4%
Last Sales Surprise	0.1%
EPS F1 Est- 4 week change	-1.1%
Expected Report Date	01/29/2020
Earnings ESP	0.4%
P/E TTM	20.2
P/E F1	18.9
PEG F1	1.6
P/S TTM	4.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,745 E	2,910 E	2,925 E	2,898 E	11,515 E
2019	2,840 A	2,925 A	2,841 A	2,716 E	11,323 E
2018	2,717 A	2,898 A	2,947 A	2,896 A	11,458 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$2.39 E	\$2.89 E	\$2.89 E	\$2.70 E	\$11.07 E
2019	\$2.51 A	\$2.70 A	\$2.58 A	\$2.29 E	\$10.04 E
2018	\$1.93 A	\$2.50 A	\$2.52 A	\$2.57 A	\$9.51 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 01/17/2020. The reports text is as of 01/20/2020.

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.

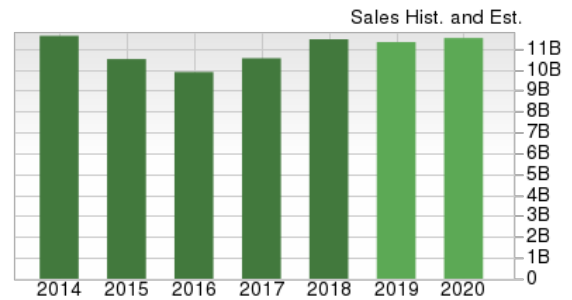
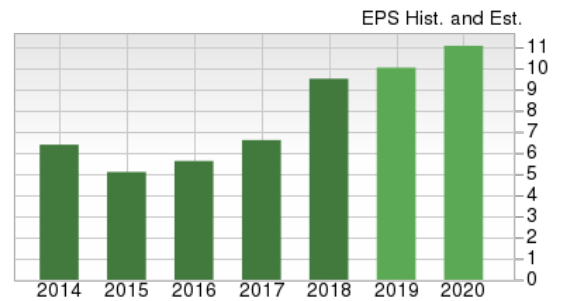
Norfolk Southern also transports overseas freight through several Atlantic and Gulf Coast ports. Norfolk Southern provides comprehensive logistics services and offers the most extensive intermodal network on the eastern side of the United States.

The company's fiscal year coincides with the calendar year. At 2018-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. Construction of the new building has already started.

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 15.9% of 2018 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 58.9% of the 2018 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 25.2% of the 2018 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). Moreover, it generated free cash flow worth \$1.8 billion in 2018. In the first nine months of 2019, the company returned \$2.3 billion to its shareholders through dividends (\$705 million) and buybacks (\$1,595 million). Notably, Norfolk Southern has hiked its quarterly dividend payout four times since the commencement of 2018. Free cash flow of \$1.5 billion was generated in the first nine months of 2019. Robust free cash flow generation by the company supports the possibility of a dividend raise going forward.
- ▲ 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 the third quarter improved to 64.8% from 65.4% a year ago. Notably, lower the value of the metric the better. This key metric improved in the first and second quarters as well. For full-year 2019, it expects the operating ratio to have improved compared with 65.4% achieved in 2018. Additionally, the company aims for a full-year operating ratio of 60% by 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, implementation of the second phase has started.

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 contracted 5% in 2018 due to decelerating vehicle production in the United States. The picture has not bettered in 2019. Automotive volumes slipped 2% in the first nine months of 2019. Apart from the automotive sub-group, key components of the merchandise segment like forest and consumer (volumes down 6% in the first nine months of 2019) plus metals and construction (volumes down 4% in the first nine months of 2019) performed dismally. With key sub-groups performing badly, volumes at the merchandise segment slid 3% in the first nine months of the year.
- ▼ 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 the first nine months of 2019, intermodal volumes at Norfolk Southern declined 2% while coal volumes shrank 8%. Due to the sluggish performance of its key divisions, overall volumes declined 3% in the first nine months of 2019. We expect Norfolk Southern's fourth-quarter overall volumes to reflect year-over-year decline as well.
- ▼ We are also concerned about the company's high-debt levels. As of Sep 30, 2019, the company's long-term debt deteriorated to \$11,085 million from \$10,560 million at 2018 end. 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 Q3

Norfolk Southern's third-quarter 2019 earnings (excluding 9 cents from non-recurring items) of \$2.58 per share surpassed the Zacks Consensus Estimate by a penny. Moreover, the bottom line improved 2.4% on a year-over-year basis owing to lower costs.

Railway operating revenues in the quarter under review came in at \$2,841 million, surpassing the Zacks Consensus Estimate of \$2,839.1 million. However, the top line declined approximately 4% year over year due to disappointing revenues at the coal and intermodal units. Overall volumes decreased 6%.

Income from railway operations declined 2% year over year to \$996 million. Operating expenses declined 4% on a year-over-year basis to \$1,845 million, primarily owing to lower fuel costs as well as expenses related to purchased services and rents. Norfolk Southern's operating ratio (operating expenses as a percentage of revenues) in the third quarter improved 50 basis points to 64.9% in the reported quarter. Notably, lower the value of the metric the better.

Segmental Performance

On a year-over-year basis, coal revenues totaled \$403 million, down 13% year over year. Coal volumes contracted 15%. Revenue per unit inched up 2% in the reported quarter.

Merchandise revenues were flat at \$1,731 million. Segmental volumes fell 4%. Revenue per unit improved 3% for the segment.

Intermodal revenues decreased 5% year over year to \$707 million. Segmental volumes also declined 5%. Revenue per unit was unaltered on a year-over-year basis.

Liquidity

The company exited the third quarter with cash and cash equivalents of \$452 million compared with \$358 million at the end of 2018. The company had long-term debt of \$11,085 million compared with \$10,560 million as of Dec 31, 2018.

Quarter Ending **09/2019**

Report Date	Oct 23, 2019
Sales Surprise	0.07%
EPS Surprise	0.39%
Quarterly EPS	2.58
Annual EPS (TTM)	10.36

Valuation

Norfolk Southern shares are up 23.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Transportation sector are up 18.9% and 11.2%, respectively, over the past year. The S&P 500 index is up 23.8% in the past year.

The stock is currently trading at 18.8X forward 12-month price-to-earnings, which compares to 18.16X for the Zacks sub-industry, 13.35X 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 22.76X and as low as 11.87X, with a 5-year median of 16.6X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$222 price target reflects 19.93X 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	18.8	18.16	13.35	19.2
	5-Year High	22.76	19.35	16.98	19.34
	5-Year Low	11.87	13.46	10.46	15.17
	5-Year Median	16.6	16.68	13.11	17.44
P/B TTM	Current	3.58	5.88	3.36	4.55
	5-Year High	3.59	5.88	4.67	4.55
	5-Year Low	1.63	2.21	2.68	2.85
	5-Year Median	2.69	4.41	3.42	3.61
P/S F12M	Current	4.76	5.53	1.16	3.57
	5-Year High	4.76	5.53	1.44	3.57
	5-Year Low	1.91	3.04	1.03	2.54
	5-Year Median	3.37	4.43	1.23	3

As of 01/17/2020

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
Kansas City Southern (KSU)	Neutral
Union Pacific Corporation (UNP)	Neutral
WEST JAPAN RAIL (WJRY)	Neutral
Canadian National Railway Company (CNI)	Underperform

Industry Comparison Industry: Transportation - Rail				Industry Peers		
	NSC Neutral	X Industry	S&P 500	CNI Underperform	CSX Neutral	UNP Neutral
VGM Score	D	-	-	F	D	D
Market Cap	54.58 B	26.27 B	24.65 B	68.62 B	59.77 B	128.65 B
# of Analysts	5	7	13	10	9	6
Dividend Yield	1.80%	1.65%	1.73%	1.69%	1.26%	2.09%
Value Score	D	-	-	F	D	D
Cash/Price	0.01	0.04	0.04	0.01	0.04	0.01
EV/EBITDA	12.71	12.71	14.11	13.33	11.67	14.04
PEG Ratio	1.57	1.98	2.08	2.12	1.44	1.96
Price/Book (P/B)	3.58	3.58	3.39	4.90	5.03	7.14
Price/Cash Flow (P/CF)	15.12	15.08	13.81	17.07	13.47	16.74
P/E (F1)	18.91	18.89	19.19	20.03	17.93	19.62
Price/Sales (P/S)	4.75	4.88	2.69	6.02	5.01	5.78
Earnings Yield	5.29%	5.30%	5.21%	4.99%	5.58%	5.09%
Debt/Equity	0.73	0.73	0.72	0.65	1.35	1.35
Cash Flow (\$/share)	13.84	5.67	6.94	5.63	5.67	11.07
Growth Score	C	-	-	D	B	C
Hist. EPS Growth (3-5 yrs)	14.51%	9.54%	10.56%	6.26%	19.91%	9.54%
Proj. EPS Growth (F1/F0)	10.28%	10.86%	7.57%	10.07%	2.16%	11.65%
Curr. Cash Flow Growth	26.47%	8.45%	14.73%	4.94%	35.99%	20.97%
Hist. Cash Flow Growth (3-5 yrs)	6.34%	6.34%	9.00%	4.63%	9.35%	5.76%
Current Ratio	0.73	0.89	1.24	0.71	1.41	0.89
Debt/Capital	42.11%	42.11%	42.99%	39.33%	57.38%	57.44%
Net Margin	23.98%	23.75%	11.14%	29.62%	27.91%	27.28%
Return on Equity	18.22%	15.63%	17.16%	24.36%	27.29%	32.65%
Sales/Assets	0.31	0.35	0.55	0.35	0.31	0.36
Proj. Sales Growth (F1/F0)	1.70%	4.51%	4.16%	5.64%	0.52%	3.03%
Momentum Score	F	-	-	D	F	F
Daily Price Chg	1.49%	0.30%	0.27%	0.50%	-0.44%	0.77%
1 Week Price Chg	0.57%	0.23%	0.39%	0.76%	0.64%	-1.68%
4 Week Price Chg	9.07%	4.41%	2.95%	6.59%	5.25%	4.42%
12 Week Price Chg	14.27%	7.45%	7.76%	8.28%	6.61%	8.76%
52 Week Price Chg	26.80%	18.61%	22.29%	17.07%	17.38%	19.84%
20 Day Average Volume	1,235,181	146,934	1,536,375	560,095	3,277,875	2,340,545
(F1) EPS Est 1 week change	-1.04%	0.00%	0.00%	0.10%	-0.38%	-0.41%
(F1) EPS Est 4 week change	-1.07%	-0.44%	0.00%	-2.23%	-0.79%	-1.22%
(F1) EPS Est 12 week change	-3.41%	-2.73%	-0.40%	-7.36%	-2.42%	-3.04%
(Q1) EPS Est Mthly Chg	1.09%	1.08%	0.00%	1.08%	-2.22%	-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	C
Momentum Score	F
VGM Score	D

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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