CSX Corporation (CSX)

Updated October 17th, 2018 by Josh Arnold

Key Metrics

Current Price:	$72	**5 Year CAGR Estimate:**	4.6%	**Volatility Percentile:**	72.7%
Fair Value Price:	$54	**5 Year Growth Estimate:**	9.0%	**Momentum Percentile:**	90.9%
% Fair Value:	134%	**5 Year Valuation Multiple Estimate:**	-5.6%	**Growth Percentile:**	82.7%
Dividend Yield:	1.2%	**5 Year Price Target**	$83	**Valuation Percentile:**	12.1%
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Total Return Percentile:**	18.1%

Overview & Current Events

CSX can trace its roots all the way back to 1827 when the B&O Railroad was first chartered. From just 13 miles of track, CSX has grown to cover 23 states and 21,000 route miles. CSX provides rail, rail-to-truck and intermodal transport services. The company's market capitalization is $62 billion, and it should do about $12 billion in revenue this year.

CSX reported Q3 earnings on 10/16/18 and results were very strong. Revenue was up 14% as volumes continue to rise, while fuel recoveries and pricing gains added to the top line as well. In addition, expenses declined 2% as the company set a Q3 record for operating ratio at just 58.7%, the product of its cost saving initiatives. Earnings-per-share rose 106% against last year's Q3 thanks to these improvements and a lower tax rate. We've boosted our 2018 estimate to $3.60 per share following the outstanding report and bullish outlook.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.17	$0.96	$1.36	$1.67	$1.79	$1.83	$1.92	$2.00	$1.81	$2.30	**$3.60**	**$5.55**
DPS	$0.26	$0.29	$0.33	$0.45	$0.54	$0.59	$0.63	$0.70	$0.72	$0.78	**$0.88**	**$1.40**
Shares	1,172	1,180	1,111	1,049	1,021	1,009	992	966	928	890	***860***	***725***

CSX' earnings-per-share has grown somewhat unpredictably over the past decade as its fortunes are tied to rail volumes and pricing strength, both of which are heavily dependent upon particular industries and economic conditions. Its leverage to the coal market as well as intermodal transport are both positives for 2018 as volumes are improving for the former on an export basis, and a very tight freight market is helping the latter with pricing. CSX stands to gain in the form of mid-single digit revenue increases in the coming years as a result, helping to fuel our estimate of 9% earnings-per-share growth. The remainder will come from improved operating efficiency leading to higher margins, as well as a sizable $5 billion buyback allowance. We see the share count declining in the low single digits annually as CSX generates strong free cash flow and puts it to use. Q3 results showed these tailwinds coming to fruition.

Likewise, we see the dividend increasing at roughly the rate of earnings, reaching $1.40 in five years from today's level of $0.88. CSX has put buybacks first in recent years but with a much-reduced capex budget for 2018 as part of its operational efficiency initiatives, more cash should be freed up for dividend increases.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.0	12.9	13.2	14.0	12.1	13.6	16.1	15.7	15.5	21.8	**20.0**	**15.0**
Avg. Yld.	1.5%	2.4%	1.8%	1.9%	2.5%	2.4%	2.0%	2.2%	2.6%	1.6%	**1.2%**	**1.9%**

CSX's price-to-earnings multiple has moved sharply higher in the past couple of years as it sits at 20.0 today versus a long-term average of 15, implying a 5.6% annual headwind to total returns. We see the stock moving back towards this historical average as recent optimism on operational efficiency improvements cannot be sustained. CSX's cost-cutting program is yielding strong results but as is the case with any such initiative, gains are necessarily finite. As a result, investors will almost certainly see the price-to-earnings multiple move back down to historical levels.

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The lower price-to-earnings ratio, combined with high rates of dividend growth, will see the yield move back towards more normalized levels as well. The current 1.2% yield is low by historical standards, owed to a very high valuation. As that situation is rectified, dividend payout growth should lead to a much higher yield.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	---	---	28.9%	29.5%	29.5%	28.9%	28.5%	30.0%	30.2%	33.1%	**33.5%**	**34.5%**
Debt/A	69%	67%	69%	71%	70%	67%	66%	66%	67%	59%	**58%**	**56%**
Int. Cov.	6.0	4.2	5.6	6.4	6.3	6.3	6.6	6.8	5.8	6.9	**7.2**	**7.8**
Payout	21%%	30%	24%	26%	30%	32%	33%	35%	40%	34%	**24%**	**25%**
Std. Dev.	45.2%	46.7%	26.4%	27.5%	18.0%	16.2%	18.0%	19.9%	23.6%	32.2%	**28.0%**	**27.0%**

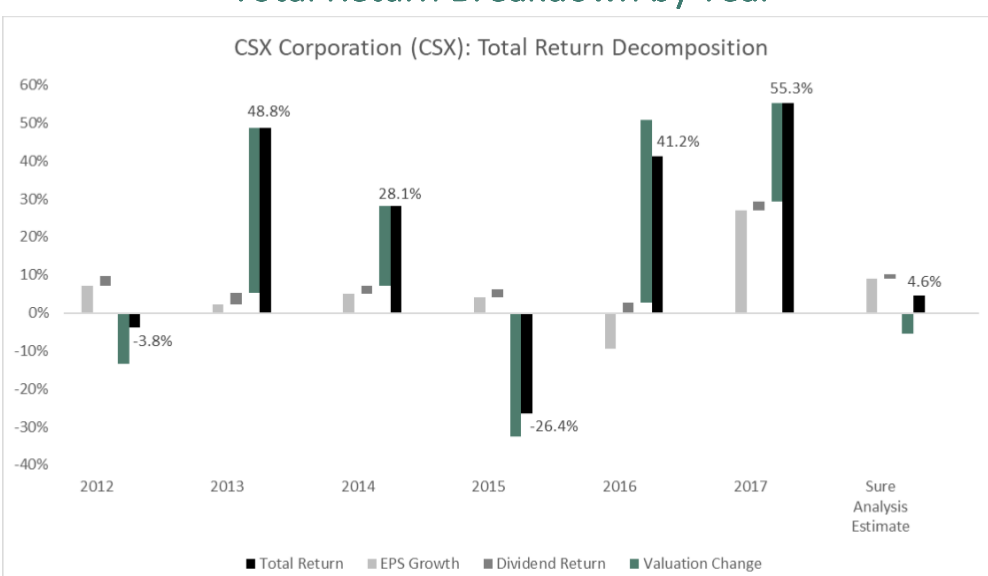
CSX' safety metrics have improved over time as its gross margins continue to tick higher and its balance sheet improves. We see continued gross margin growth from today's high levels due to the company's improving operating efficiency, which will be a key driver of earnings growth. In addition, we see the gradual deleveraging of the balance sheet continuing and leading the already-high interest coverage ratio to even higher levels. We see the payout ratio remaining about where it is today as dividend growth roughly keeps pace with earnings growth.

The company's competitive advantage is in its lean operating structure as well as its dominance in its service area. CSX looks poised to gain from its leverage to intermodal transport and the coal export market, although these things will not save it from the next recession; rail operators are particularly sensitive to economic conditions.

Final Thoughts & Recommendation

We see CSX as a stock that is trading well in excess of fair value on optimism about future earnings potential. CSX should see total annual returns in the next five years of 4.6%, consisting of the current 1.2% yield, 9% earnings growth and a 5.6% headwind from the valuation resetting to more normalized levels. CSX would therefore be appropriate for dividend growth investors as well as those seeking growth, but the low current yield and high valuation make the stock unattractive at current prices. We believe investors should wait for a more favorable entry point and rate it a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	11255	9041	10636	11795	11763	12026	12669	11811	11069	11408
Gross Profit	7477	6584	3071	3470	3464	3473	3613	3544	3339	3773
Gross Margin	66.4%	72.8%	28.9%	29.4%	29.4%	28.9%	28.5%	30.0%	30.2%	33.1%
D&A Exp.	918	903	947	976	1059	1104	1151	1208	1301	1315
Operating Profit	3618	3052	3071	3470	3464	3473	3613	3544	3339	3773
Oper. Margin	32.1%	33.8%	28.9%	29.4%	29.4%	28.9%	28.5%	30.0%	30.2%	33.1%
Net Profit	1365	1143	1563	1854	1863	1864	1927	1968	1714	5471
Net Margin	12.1%	12.6%	14.7%	15.7%	15.8%	15.5%	15.2%	16.7%	15.5%	48.0%
Free Cash Flow	1174	613	1421	1194	605	954	894	808	643	1432
Income Tax	854	618	983	1086	1108	1058	1117	1170	1027	-2329

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	26288	26887	28141	29344	30723	31782	33053	34745	35414	35739
Cash & Equivalents	669	1029	1292	783	784	592	669	628	603	401
Acc. Receivable	1107	995	993	1000	1114	1052	1129	982	938	970
Inventories	217	203	218	240	274	252	273	350	407	372
Goodwill & Int.	64	64	70	64	64	64	63	63	63	63
Total Liabilities	18220	18119	19441	20876	21587	21278	21877	23077	23720	21018
Accounts Payable	973	967	1046	1018	948	957	845	764	806	847
Long-Term Debt	7831	8008	8664	9241	9832	9555	9742	10535	11293	11809
Total Equity	8048	8754	8686	8455	9122	10483	11152	11652	11679	14705
D/E Ratio	0.97	0.91	1.00	1.09	1.08	0.91	0.87	0.90	0.97	0.80

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	5.3%	4.3%	5.7%	6.5%	6.2%	6.0%	5.9%	5.8%	4.9%	15.4%
Return on Equity	16.3%	13.6%	17.9%	21.6%	21.2%	19.0%	17.8%	17.3%	14.7%	41.5%
ROIC	8.6%	7.0%	9.2%	10.6%	10.2%	9.6%	9.4%	9.1%	7.6%	22.1%
Shares Out.	1,172	1,180	1,111	1,049	1,021	1,009	992	966	928	890
Revenue/Share	9.18	7.62	9.22	10.83	11.31	11.80	12.64	12.00	11.68	12.48
FCF/Share	0.96	0.52	1.23	1.10	0.58	0.94	0.89	0.82	0.68	1.57

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.