CSX Corporation (CSX)

Updated January 17th, 2019 by Josh Arnold

Key Metrics

Current Price:	$64	**5 Year CAGR Estimate:**	10.1%	**Volatility Percentile:**	68.2%
Fair Value Price:	$63	**5 Year Growth Estimate:**	9.0%	**Momentum Percentile:**	84.4%
% Fair Value:	101%	**5 Year Valuation Multiple Estimate:**	-0.3%	**Growth Percentile:**	83.8%
Dividend Yield:	1.4%	**5 Year Price Target**	$97	**Valuation Percentile:**	36.2%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	47.0%

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 $55 billion after some recent weakness in the stock, and it should produce almost $13 billion in revenue this year.

CSX reported Q4 earnings on 1/16/19 and results topped estimates. We saw the report as a strong one as the company managed 58% growth in adjusted earnings-per-share, rising to $1.01 in this year's Q4 against $0.64 in the comparable period last year. Results were driven in part by a tremendous improvement in the company's operating ratio, which is the ratio of expenses to revenue. That metric fell a whopping 480bps from last year's Q4 to just 60.3%, which improved profitability. In addition to that, revenue rose in every industry CSX reports for with the exception of fertilizers, which fell 3%. Particular strength was seen in chemicals, automotive, forest products and metals.

In addition to much higher revenue, the company saw improvements in terminal dwell (downtime), train velocity, and locomotive miles per day. This helped fuel the better operating ratio for Q4, along with the higher revenue totals.

Adjusted free cash flow for the full year rose 88% to $3.2 billion thanks to operating profit improvements, and that helped CSX returned $5.4 billion in cash to shareholders during the year. That was double the capital returns for 2017, with the vast majority coming via buybacks. Indeed, CSX authorized a new $5 billion buyback, which is good for about 11% of the current float. That factors into our initial estimate of $4.20 in earnings-per-share for this year, which we believe will be heavily influenced by buybacks.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.96	$1.36	$1.67	$1.79	$1.83	$1.92	$2.00	$1.81	$2.30	$3.85	***$4.20***	***$6.46***
DPS	$0.29	$0.33	$0.45	$0.54	$0.59	$0.63	$0.70	$0.72	$0.78	$0.88	***$0.88***	***$1.60***
Shares	1,180	1,111	1,049	1,021	1,009	992	966	928	890	860	***820***	***700***

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. 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 annually. 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 mid-single digits annually as CSX generates strong free cash flow and puts it to use.

Likewise, we see the dividend increasing at roughly the rate of earnings, reaching $1.60 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. CSX has raised its dividend on a somewhat irregular schedule in the past, but we expect to see a higher dividend for the February payment. With the payout ratio still very low, CSX has plenty of room to continue its streak of dividend increases while still affording it the ability to buy back stock.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	12.9	13.2	14.0	12.1	13.6	16.1	15.7	15.5	21.8	16.8	***15.2***	***15.0***
Avg. Yld.	2.4%	1.8%	1.9%	2.5%	2.4%	2.0%	2.2%	2.6%	1.6%	1.4%	***1.4%***	***1.6%***

CSX's price-to-earnings multiple has come way down in recent months and today, trades at just 15.2. That is right at fair value so we see essentially no impact from the valuation moving forward, which is a welcome respite from the excessive valuations seen in 2017. That has made CSX attractively valued for the first time in a number of years.

We see the yield as remaining roughly where it is today in the mid-1% range. CSX has not signaled it is willing to boost the payout ratio meaningfully, so we see the payout growing at similar rates as earnings.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	30%	24%	26%	30%	32%	33%	35%	40%	34%	23%	***21%***	***25%***

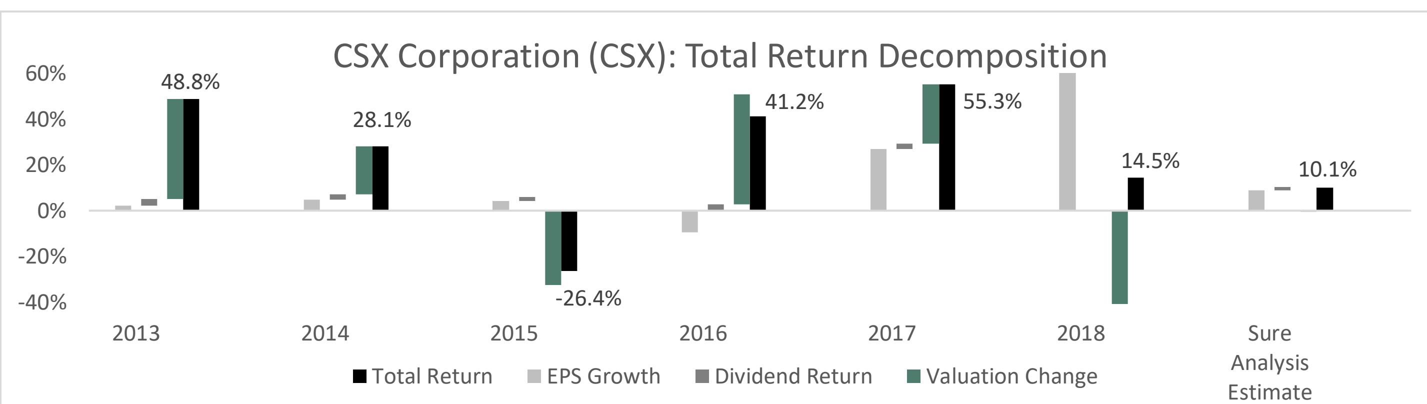
CSX' safety metrics have improved over time as its gross margins continue to tick higher and its balance sheet improves. We see continued gross margin growth from today's high levels due to the company's improving operating efficiency, which will be a key driver of earnings growth, as seen in Q4. In 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 and we see that as the key risk to owning CSX in the coming years.

Final Thoughts & Recommendation

We see CSX as a stock that is trading at fair value for the first time in years. CSX should see total annual returns in the next five years of 10.1%, consisting of the current 1.4% yield, 9% earnings growth and a 0.3% headwind from the valuation. CSX would therefore be appropriate for dividend growth investors as well as those seeking growth, but the low current yield would make it unattractive for those seeking current income. Given the lower valuation and strong growth prospects, we are upgrading CSX to a buy. The company's earnings growth is progressing nicely, in addition to growth in free cash flow and we see this fairly valued stock as a winner in the coming years.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	9041	10636	11795	11763	12026	12669	11811	11069	11408	12250
Gross Profit	6584	3071	3470	3464	3473	3613	3544	3339	3773	4773
Gross Margin	72.8%	28.9%	29.4%	29.4%	28.9%	28.5%	30.0%	30.2%	33.1%	39.0%
D&A Exp.	903	947	976	1059	1104	1151	1208	1301	1315	1331
Operating Profit	3052	3071	3470	3464	3473	3613	3544	3339	3773	4773
Operating Margin	33.8%	28.9%	29.4%	29.4%	28.9%	28.5%	30.0%	30.2%	33.1%	39.0%
Net Profit	1143	1563	1854	1863	1864	1927	1968	1714	5471	3309
Net Margin	12.6%	14.7%	15.7%	15.8%	15.5%	15.2%	16.7%	15.5%	48.0%	27.0%
Free Cash Flow	613	1421	1194	605	954	894	808	643	1432	2896
Income Tax	618	983	1086	1108	1058	1117	1170	1027	-2329	995

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	26887	28141	29344	30723	31782	33053	34745	35414	35739	36729
Cash & Equivalents	1029	1292	783	784	592	669	628	603	401	858
Acc. Receivable	995	993	1000	1114	1052	1129	982	938	970	N/A
Inventories	203	218	240	274	252	273	350	407	372	N/A
Goodwill & Int.	64	70	64	64	64	63	63	63	63	N/A
Total Liabilities	18119	19441	20876	21587	21278	21877	23077	23720	21018	24149
Accounts Payable	967	1046	1018	948	957	845	764	806	847	N/A
Long-Term Debt	8008	8664	9241	9832	9555	9742	10535	11293	11809	14757
Total Equity	8754	8686	8455	9122	10483	11152	11652	11679	14705	N/A
D/E Ratio	0.91	1.00	1.09	1.08	0.91	0.87	0.90	0.97	0.80	N/A

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	4.3%	5.7%	6.5%	6.2%	6.0%	5.9%	5.8%	4.9%	15.4%	9.1%
Return on Equity	13.6%	17.9%	21.6%	21.2%	19.0%	17.8%	17.3%	14.7%	41.5%	N/A
ROIC	7.0%	9.2%	10.6%	10.2%	9.6%	9.4%	9.1%	7.6%	22.1%	N/A
Shares Out.	1,180	1,111	1,049	1,021	1,009	992	966	928	890	860
Revenue/Share	7.62	9.22	10.83	11.31	11.80	12.64	12.00	11.68	12.48	14.23
FCF/Share	0.52	1.23	1.10	0.58	0.94	0.89	0.82	0.68	1.57	3.36

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