CSX Corporation (CSX)

Updated July 19th, 2019 by Josh Arnold

Key Metrics

Current Price:	$72	**5 Year CAGR Estimate:**	7.3%	**Volatility Percentile:**	71.7%
Fair Value Price:	$62	**5 Year Growth Estimate:**	9.0%	**Momentum Percentile:**	45.5%
% Fair Value:	117%	**5 Year Valuation Multiple Estimate:**	-3.0%	**Growth Percentile:**	86.3%
Dividend Yield:	1.3%	**5 Year Price Target**	$95	**Valuation Percentile:**	34.7%
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Total Return Percentile:**	42.6%

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 $57 billion after some recent weakness in the stock, and it should produce about $12 billion in revenue this year.

CSX reported Q2 earnings on 7/16/19 and results sent the stock 10% lower on the day. Revenue fell fractionally year-over-year as growth in the company's merchandise volume was offset by weakness in intermodal revenue. The company's CEO noted that current economic conditions are "puzzling" and that global and US economic conditions are impacting volumes negatively. He further stated that utility volumes are down due to low natural gas prices, and that there are signs of slowing shipment volumes in merchandise. He says this points to a weaker economy in the second half of the year. As a result, revenue guidance for this year was cut from $12.5 billion to ~$12 billion after the Q2 report. Understandably, this spooked investors and the stock fell materially.

On the bright side, expenses fell 3% year-over-year thanks to CSX's intense focus on cutting costs wherever it can. In fact, CSX set a record operating ratio in Q2 of 57.4%, down from an already-low 58.6% in the year-ago period. The share count was also down 7% year-over-year, helping to boost earnings-per-share by the same amount, rising from $1.01 to $1.08 in Q2.

While we like CSX's focus on cutting costs, we're lowering our earnings-per-share estimate slightly from $4.20 to $4.10 on weaker revenue guidance. We think CSX will offset some of the revenue weakness with share repurchases and margin gains, but we're certainly more cautious than we were prior to the Q2 report.

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	***$4.10***	***$6.31***
DPS	$0.29	$0.33	$0.45	$0.54	$0.59	$0.63	$0.70	$0.72	$0.78	$0.88	***$0.96***	***$1.80***
Shares	1,180	1,111	1,049	1,021	1,009	992	966	928	890	860	***800***	***700***

CSX's 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 modest revenue increases in the coming years, 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; Q2 results support this. We see the share count declining in the mid-to-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 $1.80 in five years from today's level of $0.96. CSX has put buybacks first in recent years but with a much-reduced capex budget as part of its operational efficiency initiatives, more cash should be freed up for dividend increases. 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	***17.5***	***15.0***
Avg. Yld.	2.4%	1.8%	1.9%	2.5%	2.4%	2.0%	2.2%	2.6%	1.6%	1.4%	***1.3%***	***1.9%***

CSX's price-to-earnings multiple has moved significantly higher in recent months but after the Q2 report, it has moderated somewhat to 17.5 times 2019 earnings. That is well in excess of our estimate of fair value so we see a 3% headwind to total returns from the valuation moving forward.

We see the yield moving up to 1.9% over time from the current 1.3%. This stems from the dividend moving higher but also, as the valuation reverts back to fair value, the yield will move higher.

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%	***23%***	***29%***

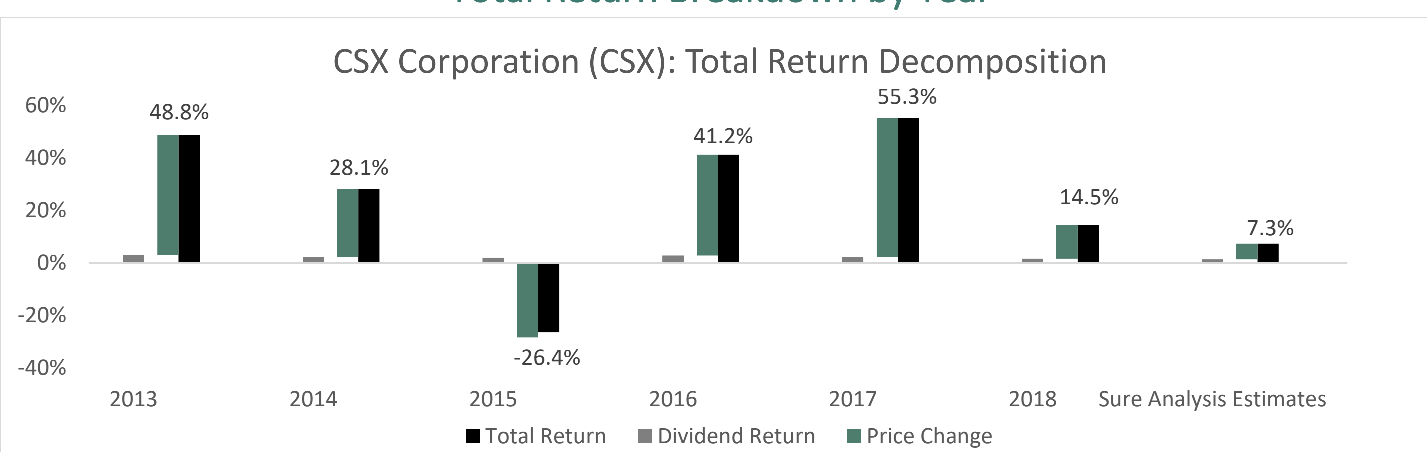
CSX's payout ratio remains fairly low and consequentially, well covered. The company has experienced high rates of earnings growth in recent years, so the payout ratio has fallen as a result of earnings rising, not because the company cannot afford to pay its dividend. Indeed, its dividend safety is outstanding.

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

In our view, CSX is still trading above fair value. It could see total annual returns in the next five years of 7.3%, consisting of the current 1.3% yield, 9% earnings growth and a 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. In addition, the valuation has kept CSX out of value stock territory once again. We are reiterating our hold rating on CSX. The company's earnings growth is progressing nicely, in addition to growth in free cash flow. However, the current valuation is still too high and the low current yield is unattractive, so we think there are better opportunities available.

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.