CSX Corporation (CSX)

Updated January 19th, 2020 by Josh Arnold

Key Metrics

Current Price:	$79	**5 Year CAGR Estimate:**	3.7%	**Market Cap:**	$59.4B
Fair Value Price:	$63	**5 Year Growth Estimate:**	7.0%	**Ex-Dividend Date:**	02/27/20[1]
% Fair Value:	126%	**5 Year Valuation Multiple Estimate:**	-4.5%	**Dividend Payment Date:**	03/15/20[2]
Dividend Yield:	1.2%	**5 Year Price Target**	$88	**Years Of Dividend Growth:**	14
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	9.1%

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 $59 billion after a recent rally in the stock, and it should produce around $12 billion in revenue this year.

CSX reported Q4 and full-year earnings on January 16th, and results were somewhat weak. Earnings-per-share came in at $0.99 in Q4 against $1.01 in the same period in 2018. For the full-year, earnings-per-share came to $4.17 against $3.85 in 2018. On a company-wide basis, earnings were essentially flat, but the company's robust share repurchase program has kept earnings-per-share moving in the right direction.

The company's operating ratio – which is the railroad industry's version of cost of goods – was 60% in Q4, a new record for that quarter. Q4 improved fractionally over the same period in 2018, which saw an operating ratio of 60.3%. For the full year, CSX's operating ratio was also a new record, coming in at 58.4%.

While CSX is continuing to deliver significant cost savings, revenue has been an increasingly large issue. Revenue in Q4 was down -8% due to lower volumes and negative mix from the company's exposure to the coal industry. Expenses fell -9% during the quarter, so damage to earnings was minimized, but the fact remains that CSX has a challenging revenue environment in front of it.

Guidance for 2020 is for revenue to come in between flat and down -2% from 2019 levels, so while some stabilization is expected, there is hardly cause for excitement. As a result, we see earnings-per-share at roughly flat for 2020 in our initial estimate of $4.20.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.36	$1.67	$1.79	$1.83	$1.92	$2.00	$1.81	$2.30	$3.85	$4.17	***$4.20***	***$5.89***
DPS	$0.33	$0.45	$0.54	$0.59	$0.63	$0.70	$0.72	$0.78	$0.88	$0.96	***$0.96***	***$1.62***
Shares[3]	1,111	1,049	1,021	1,009	992	966	928	890	860	778	***750***	***650***

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 7% earnings-per-share growth annually. The remainder will come from improved operating efficiency leading to higher margins, as well as sizable buyback spending. We see the share count declining in the mid-single-digits annually as CSX generates strong free cash flow and puts it to use. We are becoming increasingly more concerned with revenue headwinds, but operating efficiency and buybacks should keep earnings-per-share moving higher.

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[1] Estimated date
[2] Estimated date
[3] Share count in millions

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Likewise, we see the dividend increasing at roughly the rate of earnings, reaching $1.62 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.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	13.2	14.0	12.1	13.6	16.1	15.7	15.5	21.8	16.8	17.2	***18.9***	***15.0***
Avg. Yld.	1.8%	1.9%	2.5%	2.4%	2.0%	2.2%	2.6%	1.6%	1.4%	1.3%	***1.2%***	***1.8%***

CSX's price-to-earnings multiple has moved meaningfully higher since our last update and is now 18.9 times our expectation for 2020 earnings. This is well in excess of our estimate of fair value of 15 times earnings, so we see a -4.5% headwind to total returns from the valuation moving forward.

We see the yield moving up to 1.8% over time from the current 1.2%. This stems from the dividend moving higher but also, if the valuation reverts back to our estimate of fair value, the yield would move higher.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	24%	26%	30%	32%	33%	35%	40%	34%	23%	23%	***23%***	***28%***

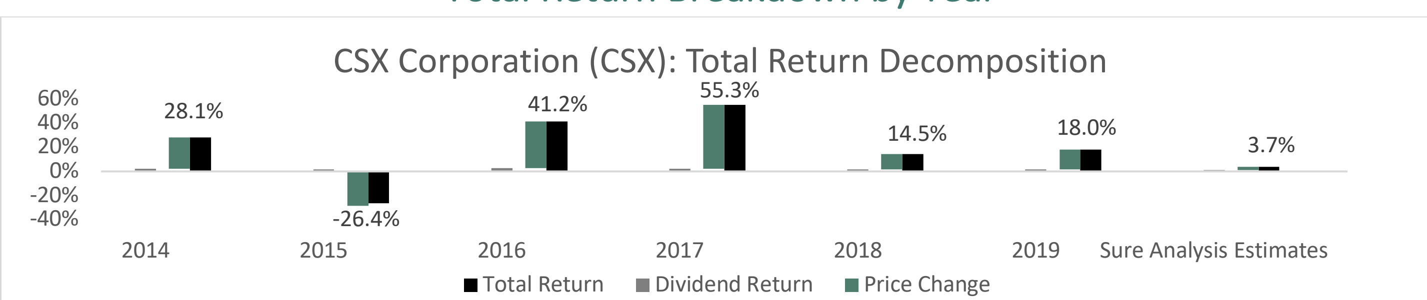
CSX's payout ratio remains low and consequentially, is well covered. The company has experienced high rates of earnings growth in recent years, so the payout ratio has fallen as a result of earnings rising, not because the company cannot afford to pay its dividend. Indeed, its dividend safety is outstanding, but we note that the company has made it clear buybacks take priority over dividend 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

In our view, CSX is trading well above fair value. It could see total annual returns in the next five years of just 3.7%, consisting of the low current yield, 7% earnings growth and a meaningful 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. Due to the move higher in the valuation once again, we are moving from hold to sell on CSX. The current valuation is far 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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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	10636	11795	11763	12026	12669	11811	11069	11408	12250	11937
Gross Profit	3071	3470	3464	3473	3613	3544	3339	3773	4773	4874
Gross Margin	28.9%	29.4%	29.4%	28.9%	28.5%	30.0%	30.2%	33.1%	39.0%	40.8%
D&A Exp.	947	976	1059	1104	1151	1208	1301	1315	1331	1349
Operating Profit	3071	3470	3464	3473	3613	3544	3339	3773	4773	4874
Operating Margin	28.9%	29.4%	29.4%	28.9%	28.5%	30.0%	30.2%	33.1%	39.0%	40.8%
Net Profit	1563	1854	1863	1864	1927	1968	1714	5471	3309	3331
Net Margin	14.7%	15.7%	15.8%	15.5%	15.2%	16.7%	15.5%	48.0%	27.0%	27.9%
Free Cash Flow	1421	1194	605	954	894	808	643	1432	2896	3193
Income Tax	983	1086	1108	1058	1117	1170	1027	-2329	995	985

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	28141	29344	30723	31782	33053	34745	35414	35739	36729	38257
Cash & Equivalents	1292	783	784	592	669	628	603	401	858	958
Acc. Receivable	993	1000	1114	1052	1129	982	938	970	N/A	
Inventories	218	240	274	252	273	350	407	372	N/A	
Goodwill & Int.	70	64	64	64	63	63	63	63	N/A	
Total Liabilities	19441	20876	21587	21278	21877	23077	23720	21018	24149	26394
Accounts Payable	1046	1018	948	957	845	764	806	847	949	
Long-Term Debt	8664	9241	9832	9555	9742	10535	11293	11809	14757	16238
Total Equity	8686	8455	9122	10483	11152	11652	11679	14705	12563	11863
D/E Ratio	1.00	1.09	1.08	0.91	0.87	0.90	0.97	0.80	1.17	1.37

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.7%	6.5%	6.2%	6.0%	5.9%	5.8%	4.9%	15.4%	9.1%	8.9%
Return on Equity	17.9%	21.6%	21.2%	19.0%	17.8%	17.3%	14.7%	41.5%	24.3%	27.3%
ROIC	9.2%	10.6%	10.2%	9.6%	9.4%	9.1%	7.6%	22.1%	12.3%	12.0%
Shares Out.	1,111	1,049	1,021	1,009	992	966	928	890	860	778
Revenue/Share	9.22	10.83	11.31	11.80	12.64	12.00	11.68	12.48	14.23	14.96
FCF/Share	1.23	1.10	0.58	0.94	0.89	0.82	0.68	1.57	3.36	4.00

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