



Norfolk Southern Corp. (NSC)

Updated August 7th, 2021 by Jonathan Weber

Key Metrics

Current Price:	\$256	5 Year CAGR Estimate:	4.6%	Market Cap:	\$63B
Fair Value Price:	\$214	5 Year Growth Estimate:	6.5%	Ex-Dividend Date:	08/06/21
% Fair Value:	120%	5 Year Valuation Multiple Estimate:	-3.5%	Dividend Payment Date:	08/20/21
Dividend Yield:	1.7%	5 Year Price Target	\$293	Years Of Dividend Growth:	5
Dividend Risk Score:	B	Retirement Suitability Score:	C	Last Dividend Increase:	10.1%

Overview & Current Events

Norfolk Southern Corporation is a freight railroad company which operates in the Southeast, East and Midwest geographic regions of the United States. Norfolk Southern services several ports on the Atlantic as well as on the Gulf coast. Norfolk Southern was founded in 1980, and is headquartered in Norfolk, VA.

Norfolk Southern reported its second quarter earnings results on July 28. The company generated revenues of \$2.8 billion during the quarter, which represents a revenue increase of 34% compared to the prior year's quarter. Revenues were higher thanks to an increase in transportation volumes, driven by the recovery from the pandemic. Norfolk Southern's operating ratio, which measures expenses relative to revenues, came in at 58.3%, which was an improvement versus the previous quarter, and which also set a new record for any quarter. The huge revenue increase on a year-over-year basis represents a trend reversal, as revenues had been flat or down in previous quarters.

Norfolk Southern's earnings-per-share came in at \$3.28 for the second quarter, which was better than what the analyst community had expected. 2020 was a down year for the company, but earnings-per-share did not decline by a lot, despite the pandemic's impact on the economy. The company expects that its businesses will see a rebound in 2021, as revenues are forecasted to grow meaningfully this year. Earnings-per-share should set a new record this year.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$5.27	\$5.37	\$5.85	\$6.39	\$5.11	\$5.62	\$6.54	\$9.52	\$10.25	\$9.25	\$11.90	\$16.30
DPS	\$1.66	\$1.94	\$2.04	\$2.22	\$2.36	\$2.36	\$2.44	\$3.04	\$3.60	\$3.76	\$4.36	\$6.41
Shares¹	330	314	309	308	298	290	284	280	262	254	250	225

Norfolk Southern's earnings-per-share grew by 8% annually in the 2008-to-2019-time frame, which included a significant decline during the last financial crisis. During 2015-2016 earnings declined as well, due to relatively weak traffic volumes, with declining coal transportation volumes being the most important factor.

2019's earnings growth was relatively in line with the historic norm, following outsized growth in 2018, caused by tax law changes. Norfolk Southern does generally benefit from economic growth, as that means that more goods are transported on its railways. Coal is becoming a less important business for the company, which is why further declines in coal transportation volumes in the future will hurt less, although they still pose a headwind in the present. Norfolk Southern continues to repurchase shares, which makes the company's share count decline meaningfully each year. This, in turn, boosts earnings-per-share growth by a couple of percentage points over the net income growth rate. Management plans to keep up its share repurchases, thus this earnings-per-share tailwind should persist.

2020 was a down year due to lower transportation volumes which were caused by the coronavirus crisis, as lockdown measures resulted in lower economic output across much of the country. 2021 should be a stronger year again, however, as the company is expecting meaningful revenue growth this year. Combined with the aggressive cost saving measures the company has taken in recent years, this should allow for record profits in 2021 and beyond.

¹ In Millions

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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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	13.1	12.7	13.2	15.9	18.1	15.7	18.7	15.8	18.9	25.3	21.5	18.0
Avg. Yld.	2.4%	2.8%	2.6%	2.2%	2.6%	2.7%	2.0%	2.1%	1.9%	1.6%	1.7%	2.2%

Norfolk Southern's shares have declined since our last update, but they are still not inexpensive. We believe that shares are fairly valued at a price to earnings multiple of around 18, which means that shares trade above fair value right now, even considering that the company will likely generate record profits this year.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	31.5%	36.1%	34.9%	34.7%	46.2%	42.0%	37.3%	31.9%	35.1%	40.6%	36.6%	39.3%

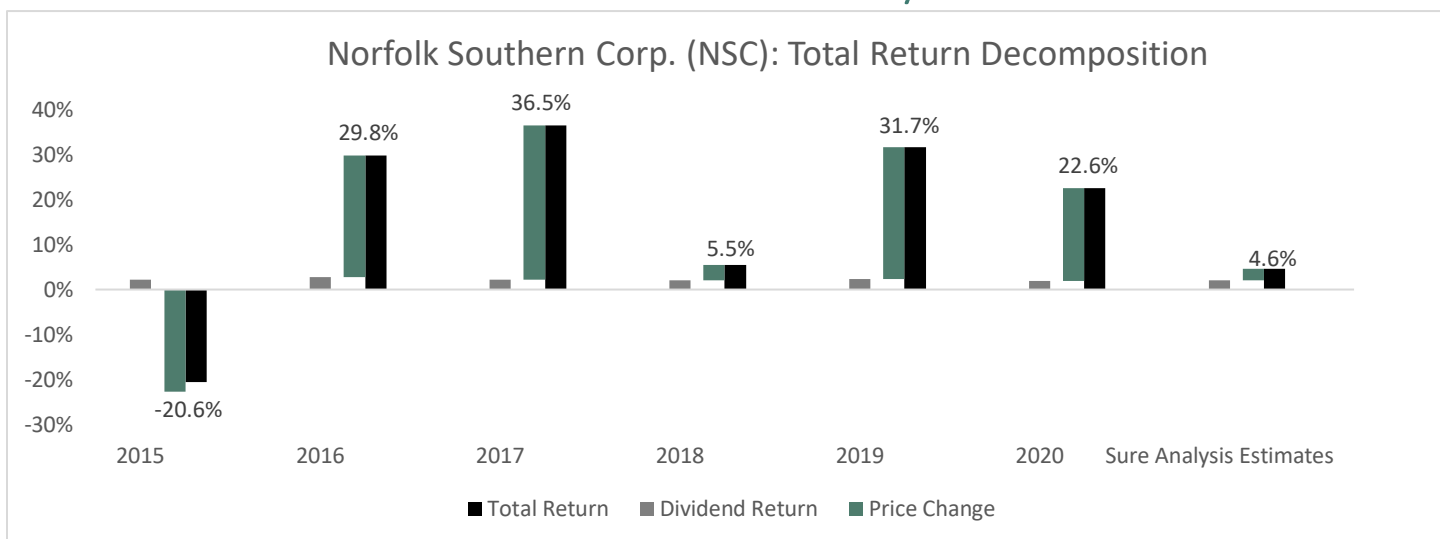
Norfolk Southern's dividend payout ratio has never been above 50%, and most of the time, the dividend payout ratio has been below 40%. This makes the company's dividend look quite safe, as even an earnings decline, such as the one during the last financial crisis or the one that was caused by the coronavirus crisis in 2020, would not make the dividend payout ratio jump anywhere close to 100%. There seems to be negligible dividend cut risk here.

The US railroad business is an oligopoly, where each of the companies is focused on certain geographic markets. There is some overlap, but generally there are no significant competitive pressures as these railroads are not trying to take market share from each other. Due to the tremendous asset base that is required to operate a railroad business, there is also a huge moat versus new market entrants. Competition is therefore not a major concern for Norfolk Southern. Norfolk Southern's business is, however, impacted by ups and downs in the economy, as traffic volumes can be cyclical. This was visible during the last financial crisis, when Norfolk Southern's profits declined by ~40% peak-to-trough.

Final Thoughts & Recommendation

Norfolk Southern is one of the largest US railroad companies. The company was hurt by lower traffic volumes in 2020, but profitability did not decline too much. Due to cost savings and the ongoing economic recovery in 2021, the company will likely see a lot of earnings growth this year. We believe that Norfolk Southern is a solid business, but shares are trading at a relatively high valuation right now, which is why we rate them a hold for now.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	11,172	11,040	11,245	11,624	10,511	9,888	10,551	11,458	11,296	9,789
Gross Profit	3,729	3,575	3,663	4,045	3,391	3,444	3,915	4,252	4,402	4,040
Gross Margin	33.4%	32.4%	32.6%	34.8%	32.3%	34.8%	37.1%	37.1%	39.0%	41.3%
SG&A Exp.				-	8	20				
D&A Exp.	869	922	922	956	1,059	1,030	1,059	1,104	1,139	1,154
Operating Profit	3,413	3,238	3,331	3,696	2,998	3,139	3,667	4,135	4,182	3,387
Op. Margin	30.5%	29.3%	29.6%	31.8%	28.5%	31.7%	34.8%	36.1%	37.0%	34.6%
Net Profit	1,916	1,749	1,910	2,000	1,556	1,668	5,404	2,666	2,722	2,013
Net Margin	17.2%	15.8%	17.0%	17.2%	14.8%	16.9%	51.2%	23.3%	24.1%	20.6%
Free Cash Flow	1,067	824	1,107	797	523	1,147	1,530	1,775	1,873	2,143
Income Tax	1,002	1,009	1,055	1,134	886	914	(2,276)	803	769	517

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	28,538	30,342	32,483	33,200	34,139	34,892	35,711	36,239	37,923	37,962
Cash & Equivalents	276	653	1,443	973	1,101	956	690	358	580	1,115
Acc. Receivable	1,022	1,109	1,024	1,055	946	945	703	740	682	848
Inventories	209	216	223	236	271	257	222	207	244	221
Total Liabilities	18,627	20,582	21,194	20,792	21,951	22,483	19,352	20,877	22,739	23,171
Accounts Payable	499	777	685	748	602	650	822	828	710	1,016
Long-Term Debt	7,540	8,682	9,448	8,985	10,093	10,212	9,836	11,145	12,196	12,681
Total Equity	9,911	9,760	11,289	12,408	12,188	12,409	16,359	15,362	15,184	14,791
D/E Ratio	0.76	0.89	0.84	0.72	0.83	0.82	0.60	0.73	0.80	0.86

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	6.8%	5.9%	6.1%	6.1%	4.6%	4.8%	15.3%	7.4%	7.3%	5.3%
Return on Equity	18.6%	17.8%	18.1%	16.9%	12.7%	13.6%	37.6%	16.8%	17.8%	13.4%
ROIC	10.9%	9.7%	9.8%	9.5%	7.1%	7.4%	22.1%	10.1%	10.1%	7.3%
Shares Out.	330	314	309	308	298	290	284	280	262	254
Revenue/Share	31.80	33.95	35.64	37.20	34.53	33.41	36.35	40.89	42.53	38.15
FCF/Share	3.04	2.53	3.51	2.55	1.72	3.88	5.27	6.33	7.05	8.35

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

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