Siena Market Line
3rd week of April 2015

CSX Corp

NYSE:CSX

Analyst: Skyler Scavone
Sector: Services

BUY

Price Target: $46.2

Key Statistics as of 4/15/15

Market Price:	$32.86
Industry:	Railroads
Market Cap:	$32.46B
52-Week Range:	$27.14-37.99
Beta:	1.09

Thesis Points:

- Leader within a promising industry
- Efficiencies increasing, headwinds decreasing
- Three tier shareholder return strategy

Company Description:

CSX Corporation ("CSX"), based in Jacksonville, Florida, was founded in 1978 and is one of the nation's leading transportation companies providing rail-based transportation services in the United States and Canada. It offers traditional rail services, and transports intermodal containers and trailers. The company transports crushed stone, sand and gravel, metal, phosphate, fertilizer, food, consumer, agricultural, automotive, paper, and chemical products; and coal, coke, and iron ore to electricity-generating power plants, steel manufacturers, and industrial plants, as well as exports coal to deep-water port facilities. In addition, the company serves the automotive industry with various distribution centers and storage locations; and connects non-rail served customers through transferring products from rail to trucks, such as plastics and ethanol. The company operates approximately 21,000 route mile rail network, which serves various population centers in 23 states east of the Mississippi River, the District of Columbia, and the Canadian provinces of Ontario and Quebec, as well as owns and leases approximately 4,000 locomotives. It also serves production and distribution facilities through track connection.

Thesis

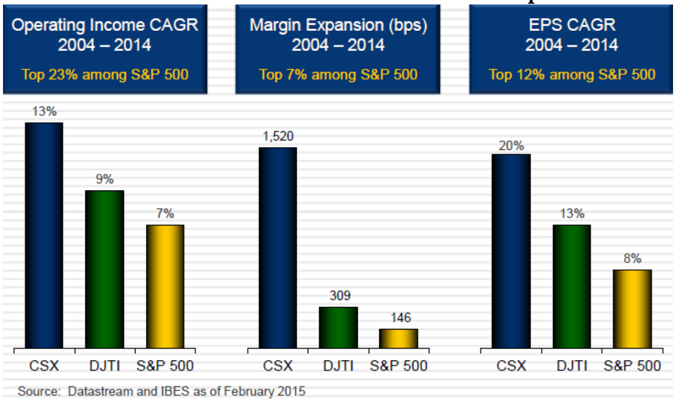
The CSX Corp is a dominant force in the eastern United States railroad industry. With the transportation sector showing strong results in the near term these types of companies should be considered for all well diversified portfolios. The Bjorkland Investment Fund currently does not own a stock in the transportation sector, but should consider CSX as it has outperformed its peers and is poised to do the same in the near term. The firm has a number of initiatives in the works to drive down costs and boost top line growth, all while keeping its three tier shareholder value creating framework in mind. For these reasons I am initiating a BUY at $32.86 with a one year price target of $46.2.

Leader within a promising industry

CSX Corp has had quite the run in the last half decade with share prices increasing more than 100% over that span. Investors might meet this level of growth with skepticism as to its sustainability. However, through the well diversified nature of the railroad industry and more specifically CSX, the growth prospects of this company remain strong. The transportation industry in general, as evidenced by the IYT (iShares Dow Jones Transportation Average, in **green**) has been outperforming the S&P 500, specifically in the past year:

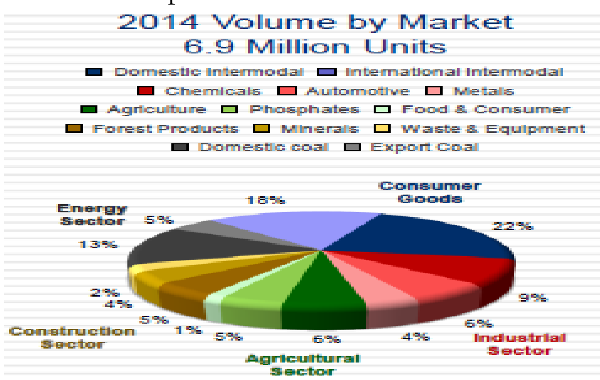
*(Trend line represents start of 2014)

This type of performance relative to the market makes it apparent that strong transportation stocks should be considered for any well diversified portfolio. One can then compare CSX's ten year performance versus the DJTI (Dow Jones Transportation Index) and the S&P 500:



With the level of financial performance relative to the industry and broader market, the returns of CSX over the last decade are not surprising. The past two quarters have been difficult for CSX and its competitors with fuel surcharges decreasing, coal volumes under pressure, and harsh weather conditions. Despite these headwinds, CSX managed to grow its volumes this quarter while a very similar east coast competitor NSC (reports 4/21) anticipates revenues to be down 5% YoY, and KSU a smaller peer also anticipates a 5% decline in revenue YoY this quarter. This can be attributed to CSX's lesser exposure to coal volumes and fuel surcharges. In the first quarter CSX reported fuel surcharges down 45% YoY (excluding two-month time lag). The fuel bill fell 39% YoY, but only 57% of the fuel bill was covered by surcharges for CSX, in comparison to competitors have ratios above 80%. This means that peers rely more on the fuel surcharge and charge more than CSX, indicating more pricing power for the firm. Therefore, falling fuel prices creates a tailwind for CSX in comparison to competitors.

While lower fuel prices put pressure on select segments within the railroad industry, the increased purchasing power of consumers and overall economic activity allow for continued growth. Here one can see the diversified nature of CSX's portfolio:



In Q4 2014 more specifically, CSX saw 60% of revenue in merchandise, 22.6% in coal and 14.6% in intermodal. In comparison NSC saw 58.5% in merchandise, 18.9% in coal and 22.6% in intermodal. Below shows a comparative breakdown of these segments:

Q4 2014 % of revenue	CSX	NSC
Revenue		
Total Merchandise	60.2	58.5
Chemicals	17.2	16.6
Agricultural Products	15.6	13.5
Automotive	9.8	8.8
Forest Products	12.4	6.8
Metals	5.3	12.8
Phosphates and Fertilizers	4.1	x
Minerals	3.6	x
Food and Consumer	2.1	x
Waste & Equipment	2.4	x
Total Coal	22.6	18.9
Intermodal	14.6	22.6

*NSC reports segments differently than CSX, the colors reflect where each stream was baked into CSX's % of revenue for an apples to apples comparison

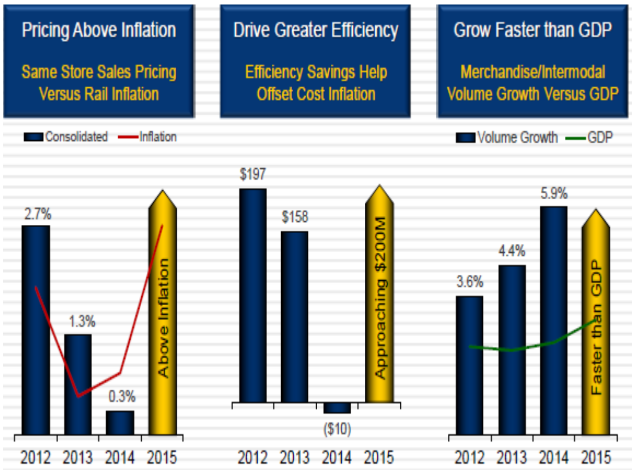
As one can see, the greatest disparity is NSC's higher level of intermodal revenue compared to CSX moving more coal as a percentage of revenue. Despite a very difficult year for coal and CSX's greater % of revenue from coal, CSX still managed to outperform its rival. Next is the 2Q 2015 outlook given by CSX:

Outlook	Markets	Drivers
Favorable 49% of volume	Food & Consumer	Continued growth in frozen food shipments
	Intermodal	Success with H2R conversions; growth with existing customers
	Minerals	Construction market driving aggregate demand
	Waste & Equipment	Increased shipment of municipal waste
Neutral 22% of volume	Agricultural Products	Strength in grain shipments offset by export demand
	Automotive	Modest growth driven by projected N.A. vehicle production
	Chemicals	Reduced energy-related drilling activities
Unfavorable 29% of volume	Domestic Coal	Lower natural gas prices
	Export Coal	Continued weakness in global market conditions
	Forest Products	Decreased demand for printing paper and newsprint
	Metals	Import supply continues to challenge U.S. steel production
	Phosphate & Fertilizer	High inventories and limited export market

Taking a look at the "unfavorable outlooks" this quarter, CSX has already proven it is actually less exposed to fuel (fuel drives coal) than its competitors making the poor Q2 coal outlook not a great concern. In the "forest products" segment (12.4% of total revenue), only paper at 6.4% of this actually falls in the unfavorable outlook category compared to 6.8% for NSC. The positive outlook markets of "minerals" and "waste" make up 3.6% and 2.4% of this segment respectively. The strong dollar is increasing imports of coal therefore reducing U.S. steel production and CSX's volume: CSX relies on 5.3% of revenue from metals compared to NSC's 12.8%. For "agricultural products" (15.6% of CSX sales): 9.4% of this segment is looking at a neutral outlook with 4.1% being unfavorable in "phosphate & fertilizer" due to late winter weather and a strong dollar affecting export markets, and 2.1% in "food & consumer" appear to have a positive outlook going forward. When weather conditions revert to average the lessened phosphate & fertilizer usage should dissipate, and low fuel prices will continue to help consumer purchasing power and drive consumption. The "intermodal" segment which NSC has a higher percent of revenue also has a positive outlook, making CSX's initiatives to grow this sector and further diversify itself against fuel and US dollar prices a positive sign. Compared to the same chart given by CSX at the end of Q4, the Q1 outlook saw 91% of volumes as favorable, perhaps a reason for decreased forecasted YoY sales. With margins about the exact same and NSC having slightly more sales, the superiorly diversified portfolio of CSX has led to higher returns on assets, capital and equity than its similarly sized peer.

Efficiencies increasing, headwinds decreasing

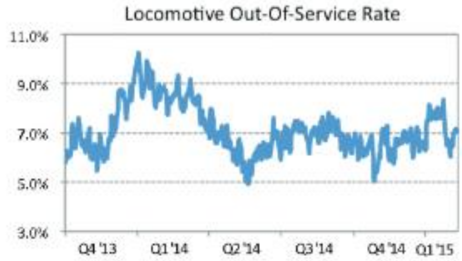
While the price of CSX seems close to fairly valued at these levels, there is still room for top and bottom line growth. In the long term CSX is looking at operating revenue as a percent of costs in the mid 60's compared to 61.3% in the LTM. A number of things will make this possible. First, cost per employee which was 27% of revenue will fall, as about 800 workers are being hired in the first half of 2015, ultimately lessening the high levels of overtime CSX has had to pay recently. Below are three ways CSX has worked to create value:



CSX has continually increased prices faster than inflation, and grown the merchandise/intermodal segments faster than GDP (more so in 2015 than previous year). In terms of cost efficiencies, the firm projects 2015 be the strongest year of savings of the past 4 and $200m greater than 2014, a year in which the share price appreciated more than 23%.

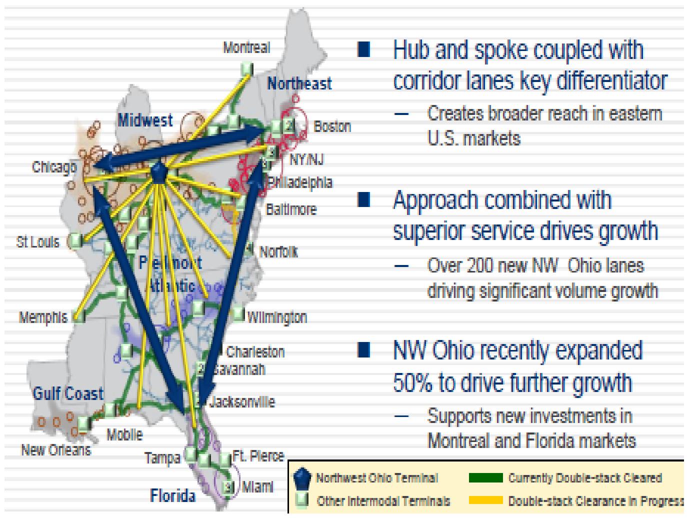
Despite a successful FY 2014, CSX did face a difficult year and endured a number of headwinds. For example, late winter weather coupled with congested West Coast ports caused average intermodal trains speeds to be down 8.7%, based on a four-week average ending March 13 compared to two years ago. Unusually cold weather late in the winter also slows agricultural production and the usage of fertilizers which make up 4.1% of CSX's revenues. Despite this fact, CSX still managed to keep revenues the same in Q1 2015 and grew EPS 12.5% YoY. Amy Rice, director of intermodal marketing at CSX Transportation said on 3/17/15, "We expect the recoverability to bounce back once the winter recedes", a positive indication for Q2 which is forecasting a 2.4% decline in YoY revenues.

CSX recognizes this decline in service and is working to combat it first by adding 200 new units in 2015. Also by "continued investment in its locomotive repair and servicing capabilities — including re-opening the Chicago facility, enhancing the Buffalo service center, and adding an additional shift in Cincinnati.." These initiatives have led to a Q1 with a locomotive out-of-service rate better than a year ago:



Another segment with great opportunity for CSX is intermodal as indicated by the U.S. highway system:

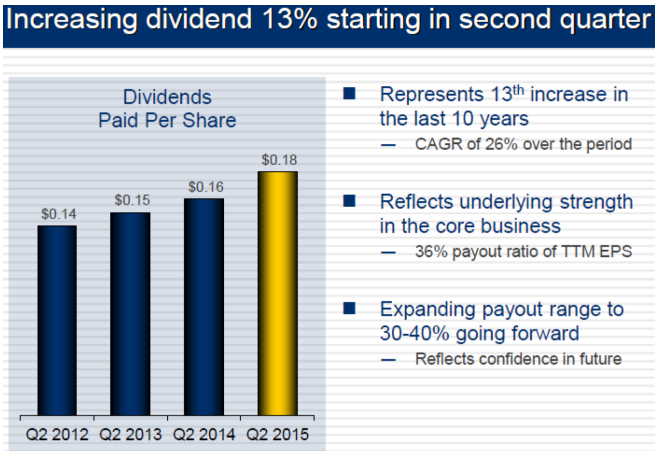
This type of congestion has led to a freight demand projection of 50% growth by 2040. The margins of intermodal are on par with the rest of Merchandise, and the opportunity in terms of volume is vast. In addition, CSX is working to drive efficiency by becoming "double-stackable" in as many routes as possible:



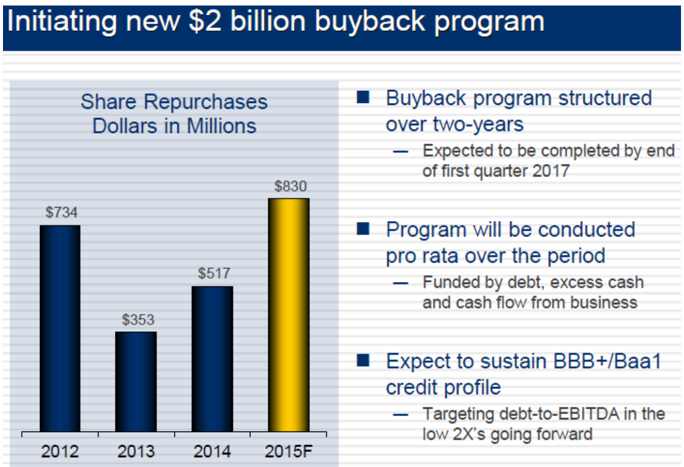
CSX is realizing the shift from fuel and coal to natural gas and is working to further diversify by expanding the intermodal share of revenue, which over time will continue to further set the company apart from its peers.

Three tier shareholder return strategy

As previously stated CSX shares grew over 23% in 2014 and over 66% since the beginning of 2013. Clearly management has developed a strategy to produce shareholder value. Michael J. Ward, CEO, cites this strategy as a balanced approach to capital deployment and cash deployment. This has led to strong dividend growth, Q2 2015 included:



He states, "So we're going to spend $2.5 billion this year, 17% of our revenues, investing for growth in the future. Secondly, this increase on our dividend takes us a little bit above a 2% yield, which some of our shareholders value that dividend and we think we want to be a little bit above the average for the S&P 500. And the share buybacks at $2 billion we think helps those shareholders that like buybacks. So we think that balanced deployment of doing all three really is the best way to create shareholder value, as we've done over the past decade". Owning this company grants the investor a management team that is shareholder conscious and versatile:



As one can see buybacks in 2015 are only slightly less than the past two years combined, indicating management's belief that now is good time to own its shares.

An investor might be concerned with the levels of debt for the firm (46%) but thanks to the high production of cash flows the quick and current ratios of the firm are improving, as well as the Altman z-score.

Pro forma assumptions

The proforma analysis of CSX netted a weighted price per share today of $34.23, slightly above the market price, and a lower bound 1y-target of $46.2. This 1 year target was comprised of a 75% weighted UDCF valuation and a 25% weight relative valuation. Base year and long term unlevered beta convergence are using the peer's historical median. Operating costs/rev. reversion is towards 68% while the firm hopes for a number closer to 65%. When these were chosen the intrinsic value was very close to the market price, adding confidence to my assumptions.

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3rd week of April 2015

CENTER FOR GLOBAL FINANCIAL STUDIES

CSX Corp.	CSX	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	Target Return	BULLISH
		Skyler Scavone	$33.11	$33.27	$46.16	2%	1-y Return: 41.59%	

General Info

Sector	Industrials
Industry	Road and Rail
Last Guidance	Apr-15-2015
Next earnings date	7/14/2015

Market Data

Enterprise value	$41,853.74
Market Capitalization	$2,032.29
Daily volume	0.25
Shares outstanding	991.59
Diluted shares outstanding	998.00
% shares held by institutions	99.58%
% shares held by insiders	0.33%
Short interest	0.84%
Days to cover short interest	0.00
52 week high	$37.99
52-week low	$27.14
5y Beta	1.30
6-month volatility	23.90%

Peers	Market Cap.
Norfolk Southern Corporation	$32,824.56
Canadian National Railway Company	$66,387.11
Canadian Pacific Railway Limited	$38,227.98

Current Capital Structure

Total debt/market cap	29.58%
Cost of Borrowing	5.90%
Interest Coverage	2.1x
Altman Z	2.12
Debt Rating	B
Levered Beta	2.73
WACC (based on market value weights)	6.10%

Management

Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014
Ward, Michael	Chairman of The Board, Chief Ex	$8,090,122	$12,444,632	$10,068,089
Munoz, Oscar	President and Chief Operating Off	$3,711,038	$3,942,829	$3,775,546
Eliasson, Fredrik	Chief Financial Officer and Executi	$3,804,019	$4,037,125	$4,040,994
Fitzsimmons, Ellen	Executive Vice President of Law &	$3,215,178	$2,742,225	$3,540,866
Gooden, Clarence	Chief Commercial Officer and Exe	$2,906,376	$4,084,960	$3,575,519
Sizemore, Carolyn	Principal Accounting Officer, Vice I	$0	$0	$0

Historical Median Performance

	CSX	Peers	Industry	All U.S. firms
Growth	4.5%	5.6%	9.1%	7.4%
ROC	9.8%	9.4%	13.9%	11.8%
NOPLAT Margin	18.5%	19.4%	17.7%	10.4%
Revenue/Total Capital	0.53	0.48	0.78	1.13
Excess Cash/Rev.	9.0%	4.3%	13.5%	12.9%
Total Cash /Rev.	9.0%	5.3%	12.3%	15.2%
Unlevered Beta	0.89	0.68	1.03	0.95
TEV/REV	2.5x	3.5x	3.3x	2.5x
TEV/EBITA	9.8x	18.2x	13.2x	13.1x
PE (normalized and diluted EPS)	14.8x	16.2x	20.6x	23.5x
P/BV	2.2x	2.3x	2.5x	2.2x

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS
Last Quarter	0.7%	2.7%	2.3%
Last Quarter-1	0.1%	-2.4%	0.0%
Last Quarter -2	2.2%	6.7%	6.3%
Last Quarter -3	-1.0%	1.0%	1.9%
Last Quarter -4	0.8%	-0.7%	8.1%

Non-GAAP Adjustments in estimates computations

Operating Leases Capitalization	100%	Straightline	10 years
R&D Exp. Capitalization	100%	Straightline	10 years
Expl./Drilling Exp. Capitalization	0%	N/A	N/A
SG&A Capitalization	0%	N/A	N/A

Proforma Assumptions

Money market rate as of today	0.54%
Annual increase (decrease) in interest rates	0.1%
Yield Spread acceleration	1.2
Marginal Tax Rate	37.5%
Risk-Free rate	2.6%
Tobin's Q	0.80
Op. Cash/Rev.	7%
Growth in PPE	NPPE Growth follows Revenue Growth
Long term Growth	4.0%
Base Year Unlevered Beta	is equal to 0.68
Long term Unlevered Beta	0.68

Forecast

Period	Rev. Growth	Adj. Op. Cost/Rev	Capital	NOPLAT Margin	ROC	WACC
LTM	5.3%	61.3%	$21,577.00	18%	9.4%	6.1%
NTM	-1.0%	61.9%	$33,321.27	19%	11.4%	6.4%
NTM+1	5.1%	62.6%	$34,549.41	18%	7.3%	6.5%
NTM+2	5.0%	63.3%	$35,864.50	17%	7.1%	6.6%
NTM+3	4.8%	64.0%	$37,236.32	17%	6.9%	6.7%
NTM+4	4.7%	64.6%	$38,646.13	16%	6.8%	6.8%
NTM+5	4.6%	65.3%	$40,082.22	16%	6.6%	6.9%
NTM+6	4.4%	66.0%	$41,535.95	15%	6.5%	7.0%
NTM+7	4.3%	66.7%	$42,999.19	15%	6.4%	7.1%
NTM+8	4.2%	67.3%	$44,464.64	15%	6.2%	7.1%
Continuing Period	4.0%	68.0%	$38,101.65	12%	10.0%	7.2%

Valuation

Period	Capital x (ROC-WACC)	Total Debt	Other non-interest bearing claims	Shares Outstanding
LTM	$0.00	$9,741.00	$518.63	991.59
NTM	$1,068.66	$9,741.00	$238.26	991.59
NTM+1	$257.64	$9,741.00	$130.55	991.59
NTM+2	$161.63	$9,741.00	$77.24	991.59
NTM+3	$76.39	$9,741.00	$51.15	991.59
NTM+4	-$7.68	$9,741.00	$38.67	991.59
NTM+5	-$95.57	$9,741.00	$33.00	991.59
NTM+6	-$189.98	$9,741.00	$30.76	991.59
NTM+7	-$292.38	$9,741.00	$30.22	991.59
NTM+8	-$402.10	$9,741.00	$30.55	991.59
Continuing Value	$35,177.56			

Pricing Model

Period	DCF (Weight = 75%)	Relative (Weight = 25%)	Distress (Weight = 0%)	Weighted Average Price Per Share
LTM	$34.08	$34.65	$29.72	$34.23
NTM	$47.34	$45.63	$42.27	$46.91
NTM+1	$48.96	$47.92	$44.05	$48.70
NTM+2	$51.64	$49.98	$46.74	$51.23
NTM+3	$54.57	$51.66	$49.69	$53.84
NTM+4	$57.89	$53.30	$52.90	$56.75
NTM+5	$61.15	$54.87	$56.85	$59.58
NTM+6	$64.84	$55.78	$61.24	$62.58
NTM+7	$68.83	$56.43	$66.14	$65.73
NTM+8	$72.87	$56.91	$71.54	$68.88

Monte Carlo Simulation Assumptions

	Base	Stdev	Min	Max	Distribution
Revenue Variation	0	10%	N/A	N/A	Normal
Op. Costs Variation	0	10%	N/A	N/A	Normal
Country Risk Premium	6%	N/A	5%	7%	Triangular
Long term Growth	4%	N/A	3%	9%	Triangular

Monte Carlo Simulation Results

	Intrinsic Value	1y-Target
Mean est.	$34.23	$46.91
σ(ε)	$0.32	$0.25
3 σ(ε) adjusted price	$33.27	$46.16
Current Price	$33.11	
Analysts' median est.		$36.67