Canadian National(CNI)

$94.47 (As of 02/10/20)

Price Target (6-12 Months): **$99.00**

Long Term: 6-12 Months	**Zacks Recommendation:**		**Neutral**
	(Since: 02/09/20)		
	Prior Recommendation: Underperform		
Short Term: 1-3 Months	**Zacks Rank:** (1-5)		**3-Hold**
	Zacks Style Scores:		VGM:F
	Value: D	Growth: D	Momentum: F

Summary

Canadian National's efforts to add shareholder value holds promise. This January, the company announced a 7% hike in its dividend payout. Simultaneously, the board cleared a new share repurchase program to buy (for cancellation) up to 16 million shares worth up to $1.5 billion under a normal course issuer bid. The company's earnings view for 2020 is also encouraging. Earnings per share are expected to grow in the mid-single-digit range during 2020 despite sluggish freight demand. However, the eight-day rail strike weighed heavily on fourth-quarter results with both the top and the bottom line declining. Also, freight revenues, accounting for bulk of the top line, decreased 5.4% in the quarter. Deterioration in the operating ratio is also a concern. Due to these headwinds, shares of the company have underperformed its industry in a year.
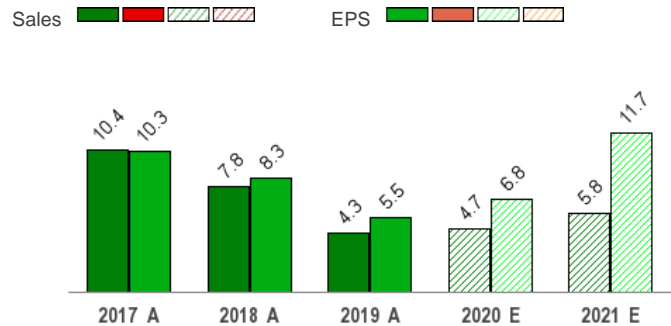
Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$96.53 - $80.95**
20 Day Average Volume (sh)	**874,315**
Market Cap	**$67.5 B**
YTD Price Change	**4.4%**
Beta	**0.99**
Dividend / Div Yld	**$1.74 / 1.7%**
Industry	**Transportation - Rail**
Zacks Industry Rank	**Bottom 34% (168 out of 255)**
Last EPS Surprise	**4.4%**
Last Sales Surprise	**1.0%**
EPS F1 Est- 4 week change	**-2.1%**
Expected Report Date	**05/04/2020**
Earnings ESP	**0.0%**
P/E TTM	**21.6**
P/E F1	**20.1**
PEG F1	**1.9**
P/S TTM	**6.0**

Sales and EPS Growth Rates (Y/Y %)

Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021					12,524 E
2020	2,692 E	3,029 E	3,054 E	2,996 E	11,837 E
2019	2,666 A	2,960 A	2,901 A	2,715 A	11,302 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					$5.24 E
2020	$0.86 E	$1.31 E	$1.31 E	$1.19 E	$4.69 E
2019	$0.88 A	$1.29 A	$1.26 A	$0.95 A	$4.39 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/10/2020. The reports text is as of 02/11/2020.

Overview

Based in Montreal, Canada, Canadian National Railway Company is engaged in the rail and related transportation business. It operates as the largest rail network in Canada and the only transcontinental network in North America. The company's rail network serves major Canadian ports and includes connections to the United States.

The company was founded in 1919. It is responsible for transporting more than C$250 billion worth of goods annually for a wide range of business sectors, ranging from resource products to manufactured products to consumer goods, across a vast rail network.

The network covers Canada and mid-America and spans across approximately 20,000 route-miles. Its calendar year coincides with the fiscal year. It is investing actively toward expanding its network. The company's fiscal year coincides with the calendar year.

Canadian National generates revenues from rail freight (accounted for 95.2% of 2019 revenues) and other sources (4.8%). Canadian National is continuously seeking productivity initiatives to grow steadily, reduce costs and leverage its assets.

Canadian National purchased Winnipeg-based TransX in March 2019 in a bid to serve its customers in a more efficient manner. The company's rail freight operations are classified into seven business segments:

EPS Hist. and Est.

Sales Hist. and Est.

- **Petroleum and Chemicals** (accounted for 20.5% of 2019 rail freight revenues) comprises commodities, including chemicals, sulfur, plastics, petroleum products and liquefied petroleum gas (LPG) products.

- **Metals and Minerals** (11%) consists of nonferrous metals, concentrates, iron ore, steel, aluminum, construction materials, machinery and dimensional loads.

- **Forest Products** (12.1%) includes various types of lumber, panels, paper, wood pulp and other fibers, such as logs, recycled paper and wood chips.

- **Coal** (4.4%) consists of thermal grades of bituminous coal. It also includes the transport of Canadian metallurgical coal.

- **Grains and Fertilizers** (16%) comprises three primary segments: food grains, feed grains, oilseeds and oilseed products.
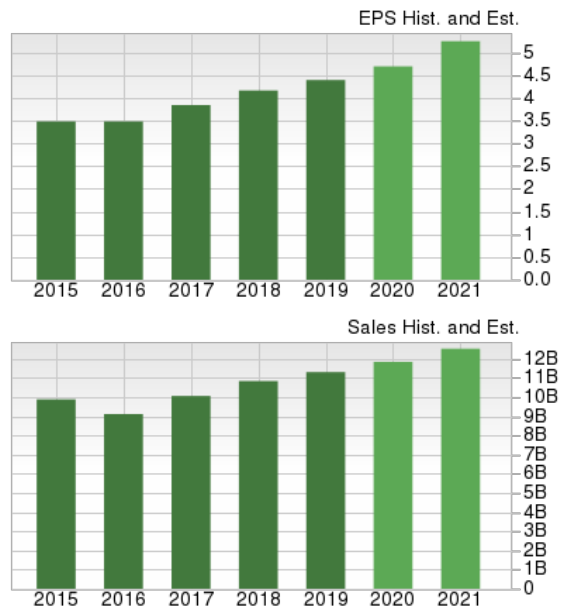
Reasons To Buy:

▲ Despite lackluster freight demand, the company's outlook for the ongoing year is quite promising. Canadian National anticipates revenue ton miles (RTMs) to witness single-digit volume growth in the current year. Moreover, the company aims for 2020 earnings per share (adjusted) growth in the mid-single-digit range compared with C$5.80 reported in 2019. The encouraging view is owing to the expectation of substantial growth in crude volumes in 2020. Notably, crude carloads rose 20% for full year 2019.

> The company's earnings forecast for 2020 holds promise. Its measures to add shareholder value are also appreciative.

▲ We are impressed by the company's efforts to improve rail infrastructure and increase capacity. Over the past two years, it incurred C$7.4 billion in capital expenditures to increase capacity, efficiency and resiliency of the network. Additionally, the company's buyout of The TransX Group of Companies bolstered its supply chain and intermodal businesses across North America. Its long-term deal with Teck Resources Ltd running from April 2021 through December 2026 should drive growth going forward. Under this pact, Canadian National will ship steelmaking coal from Teck's four British Columbia operations between Kamloops and Neptune Terminals, and other West Coast ports. Additionally, Canadian National plans to invest more than C$125 million in improving rail infrastructure and helping with the expanded volume of shipments to the Neptune facility.

▲ The company's efforts to reward shareholders through dividend payments and share buybacks also raise optimism. The company has raised dividends consecutively for 24 years. The latest hike was announced in January 2020, when the company's board of directors approved a 7% hike in its quarterly cash dividend to C$0.575 per share. Moreover, the company's board approved a new share repurchase program to buy (for cancellation) up to 16 million shares worth up to $1.5 billion under a normal course issuer bid (Bid). The Bid commenced on Feb 1, 2020 and will run through Jan 31, 2021. In 2019, the company returned nearly 80% of its adjusted net income through dividends and share repurchases.

Reasons To Sell:

▼ Canadian National's eight-day rail strike took a significant toll on its performance as can be seen from fourth-quarter results. With reduced volumes being shipped across all segments following the eight-day rail strike (Nov 19- 26), the company's bottom line declined 15.9% year over year while the top line decreased 5.8%. The top line was negatively impacted by soft freight demand as well. Notably, freight revenues fell 5.4% in the fourth quarter. With freight revenues contributing more than 90% to the top line, sluggish freight demand may put substantial pressure on the top line going forward.

▼ Decline in operating ratio (operating expenses as a percentage of revenues) in 2019 also raises concerns. With operating expenses increasing 5.6% in 2019, operating ratio deteriorated to 62.5% compared with 61.7% in 2018. Lower the value of this key metric, the better. Persistent deterioration in this metric does not bode well for the company.

▼ Although the company's capital investments are expected to fall in 2020 to C$3 billion compared with the 2018 and 2019-levels, the amount is high enough to affect its bottom line going forward. The company's high debt levels are also a cause for concern. As of Dec 31, 2019, long-term debt increased to C$11,866 million compared with C$11,385 million in December 2018.

Soft freight demand is affecting freight revenues. Deterioration in the operating ratio is also worrisome.

Last Earnings Report

Earnings Beat at Canadian National in Q4

Canadian National's fourth-quarter earnings (excluding 3 cents from non-recurring items) of 95 cents per share (C$1.22) beat the Zacks Consensus Estimate by 4 cents. The bottom line, however, declined 15.9% year over year.

Although quarterly revenues of $2,715.5 million (C$3,584 million) surpassed the Zacks Consensus Estimate of $2,690 million, the same declined 5.8% year over year, primarily due to reduced volumes being shipped across all segments following the eight-day rail strike (Nov 19-26). Lackluster freight demand also negatively impacted the top line. Notably, freight revenues, which contributed 95.1% to the top line, declined 5.4% in the quarter under review.

On a year-over-year basis, freight revenues declined across all segments apart from Intermodal where the same increased 4%. Freight revenues in Petroleum and Chemicals, Metals and Minerals and Forest Products segments declined 7%, 10% and 11%, respectively. Meanwhile, the same also declined in the Coal (14%), Grain and Fertilizers (6%) and Automotive (8%) units. While overall carloads declined 7% year over year, revenue ton miles (RTMs) slipped 13%. However, freight revenue per carload ascended 4% in the reported quarter. Freight revenue per RTM also increased 9%.

Segment-wise, carloads declined in the Petroleum and Chemicals, Metals and Minerals and Forest Products segments by 8%, 8% and 15%, respectively. The metric also dropped in the Coal (16%), Grain and Fertilizers (7%), Intermodal (4%) and Automotive (8%) units. However, operating expenses remained flat in the fourth quarter at C$2,356 million. Adjusted operating income declined 16% year over year to C$1,249 million. Adjusted operating ratio (defined as operating expenses as a percentage of revenues) deteriorated to 65.2% from the year-ago quarter's 61.2%. Notably, a lower value of this key metric is desirable.

Liquidity

The company exited the year with cash and cash equivalents of C$64 million compared with the C$266 million recorded at the end of 2018. The company generated free cash flow of C$493 during the final quarter of 2019 compared with the year-ago period's C$633 million. Long-term debt amounted to C$11,866 million as of Dec 31, 2019 compared with C$11,385 million at 2018-end.

Decent 2020 Outlook

RTMs are expected to witness single-digit volume growth in the current year despite the lackluster freight scenario. Moreover, the company aims at 2020 earnings per share (adjusted) growth in the mid-single-digit range compared with the C$5.80 reported in 2019. The company aims to generate free cash flow of C$3-3.3 billion this year compared with the prior year's C$2 billion.

Capital expenditure in 2020 is targeted at C$3 billion. In addition, the railroad operator aims to buy back up to 16 million shares in a 12-month period, starting Feb 1, 2020.

Quarter Ending	12/2019
Report Date	Jan 28, 2020
Sales Surprise	0.95%
EPS Surprise	4.40%
Quarterly EPS	0.95
Annual EPS (TTM)	4.38

Earnings Beat at Canadian National in Q4

Recent News

Deal Ratification With Teamsters — Feb 1, 2020

Canadian National announced the ratification of its labor deal with Teamsters Canada Rail Conference representing 3,200 conductors and yard crews, who initiated an eight-day long strike agitating over safety issues and working conditions including time to take break and benefits. This, in turn, took a significant toll on the company. The three-year agreements offer wage raises and benefit enhancements.

Share Buyback & Dividend Hike — Jan 29, 2020

Canadian National's board cleared a new share repurchase program to buy (for cancellation) up to 16 million shares under a normal course issuer bid (Bid). The Bid commenced on Feb 1, 2020 and will run through Jan 31, 2021.

Additionally, the company's board approved a 7% increase in its quarterly dividend to C$0.575. The new dividend will be paid out on Mar 31, 2020 to its shareholders of record on Mar 10. In fact, the current raise marks the company's 24th consecutive year of dividend hike.

Valuation

Canadian National shares are up 15.8% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Zacks Transportation sector are up 15.1% and 2.7% respectively.

The S&P 500 index is up 21.2% over the past year.

The stock is currently trading at 19.88X forward 12-month price-to-earnings, which compares to 18.31X for the Zacks sub-industry, 13.06X for the Zacks sector and 19.27X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.35X and as low as 13.79X, with a 5-year median of 18.18X. Our neutral recommendation indicates that the stock will perform in-line with the market. Our $99 price target reflects 20.84X forward 12-month earnings.

The table below shows summary valuation data for CNI

Valuation Multiples - CNI		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	19.88	18.31	13.06	19.27
	5-Year High	21.35	19.35	17	19.34
	5-Year Low	13.79	13.46	10.48	15.18
	5-Year Median	18.18	16.68	13.16	17.47
P/B TTM	Current	4.96	5.89	3.21	4.32
	5-Year High	5.63	5.94	4.65	4.42
	5-Year Low	3.21	2.21	2.68	2.85
	5-Year Median	4.58	4.41	3.41	3.62
P/S F 12M	Current	5.66	5.56	1.12	3.55
	5-Year High	6.35	5.56	1.44	3.55
	5-Year Low	3.9	3.04	1.02	2.54
	5-Year Median	5.32	4.43	1.21	3

As of 02/10/2020

Industry Analysis Zacks Industry Rank: Bottom 34% (168 out of 255)

Top Peers

Berkshire Hathaway Inc. **(BRK.B)**	Neutral
Canadian Pacific Railway Limited **(CP)**	Neutral
Kansas City Southern **(KSU)**	Neutral
Norfolk Southern Corporation **(NSC)**	Neutral
Union Pacific Corporation **(UNP)**	Neutral
United Parcel Service, Inc. **(UPS)**	Neutral
WEST JAPAN RAIL **(WJRYY)**	Neutral
CSX Corporation **(CSX)**	Underperform

Industry Comparison Industry: Transportation - Rail / Industry Peers

	CNI Neutral	X Industry	S&P 500	CP Neutral	KSU Neutral	NSC Neutral
VGM Score	F	-	-	D	C	C
Market Cap	67.46 B	36.68 B	24.17 B	36.68 B	16.54 B	53.95 B
# of Analysts	10	6	13	10	7	9
Dividend Yield	1.72%	1.68%	1.77%	0.95%	0.93%	1.80%
Value Score	D	-	-	D	D	D
Cash/Price	0.01	0.03	0.04	0.00	0.01	0.01
EV/EBITDA	13.39	12.15	13.89	14.87	15.64	12.47
PEG Ratio	1.91	1.93	2.05	1.88	1.43	1.92
Price/Book (P/B)	4.96	3.59	3.27	6.79	3.49	3.59
Price/Cash Flow (P/CF)	15.50	14.02	13.60	17.57	15.91	14.02
P/E (F1)	20.14	19.03	19.00	19.26	21.42	18.75
Price/Sales (P/S)	6.00	4.98	2.66	6.25	5.77	4.78
Earnings Yield	4.96%	5.26%	5.26%	5.19%	4.67%	5.33%
Debt/Equity	0.66	0.78	0.71	1.15	0.68	0.78
Cash Flow ($/share)	6.09	6.09	6.89	15.23	10.81	14.93
Growth Score	D	-	-	C	B	B
Hist. EPS Growth (3-5 yrs)	6.49%	10.99%	10.85%	10.99%	9.46%	16.82%
Proj. EPS Growth (F1/F0)	6.83%	9.93%	7.22%	12.18%	16.40%	7.94%
Curr. Cash Flow Growth	6.26%	2.96%	8.88%	19.36%	8.60%	3.26%
Hist. Cash Flow Growth (3-5 yrs)	3.06%	5.61%	8.36%	6.46%	5.61%	5.66%
Current Ratio	0.66	0.93	1.22	0.57	1.48	0.90
Debt/Capital	39.68%	43.90%	42.90%	53.52%	40.48%	43.90%
Net Margin	28.25%	23.84%	11.81%	31.31%	18.80%	24.10%
Return on Equity	23.28%	15.87%	16.98%	32.44%	13.69%	18.04%
Sales/Assets	0.34	0.35	0.54	0.35	0.30	0.30
Proj. Sales Growth (F1/F0)	5.29%	3.83%	4.06%	7.35%	5.68%	-0.02%
Momentum Score	F	-	-	F	B	B
Daily Price Chg	0.25%	-0.14%	0.45%	0.27%	0.08%	-0.44%
1 Week Price Chg	0.85%	0.85%	2.47%	0.45%	1.88%	0.95%
4 Week Price Chg	1.13%	1.91%	0.95%	1.91%	7.40%	4.48%
12 Week Price Chg	0.91%	4.78%	5.05%	9.79%	11.21%	8.21%
52 Week Price Chg	16.08%	16.08%	16.18%	35.21%	67.28%	18.25%
20 Day Average Volume	874,315	745,938	1,999,386	389,452	1,204,325	1,695,532
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-2.13%	-0.83%	0.00%	-0.20%	1.19%	-0.21%
(F1) EPS Est 12 week change	-7.46%	-1.92%	-0.18%	-0.28%	0.83%	-1.30%
(Q1) EPS Est Mthly Chg	-8.66%	-3.76%	0.00%	-2.85%	-2.57%	-2.56%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	D
Momentum Score	F
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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