Canadian National(CNI)

$90.98 (As of 06/10/20)

Price Target (6-12 Months): **$96.00**

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:B
	Value: D	Growth: B	Momentum: A

Summary

Shares of Canadian National have underperformed its industry in a year's time, mainly due to sluggish freight demand, which is hurting freight revenues (accounts for more than 90% of the top line). The coronavirus outbreak is a further setback and is hurting operations due to network disruptions. Consequently, overall volumes are weak with softness in intermodal and automotive sectors. The company's high debt levels are also worrisome. However, improvement in the operating ratio (operating expenses as a percentage of revenues) ratio mainly due to low fuel costs is encouraging. We are also positive about the company's buyout of TransX, which bolstered its supply chain and intermodal businesses across North America. The company's commitment to reward its shareholders despite adversities is also appreciative.
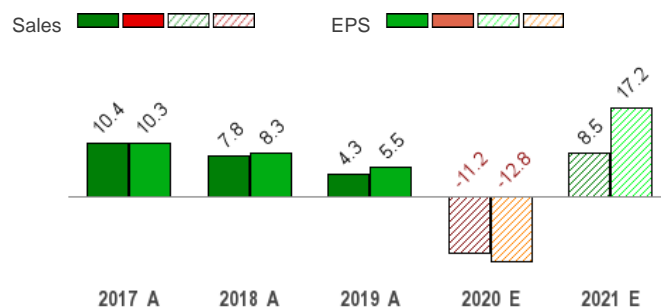
Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$96.53 - $65.13**
20 Day Average Volume (sh)	**820,428**
Market Cap	**$64.7 B**
YTD Price Change	**0.6%**
Beta	**0.88**
Dividend / Div Yld	**$1.64 / 1.8%**
Industry	**Transportation - Rail**
Zacks Industry Rank	**Bottom 18% (206 out of 252)**
Last EPS Surprise	**19.7%**
Last Sales Surprise	**7.6%**
EPS F1 Est- 4 week change	**0.4%**
Expected Report Date	**07/21/2020**
Earnings ESP	**2.6%**
P/E TTM	**20.6**
P/E F1	**23.8**
PEG F1	**2.5**
P/S TTM	**5.8**

Sales and EPS Growth Rates (Y/Y %)

Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021					10,886 E
2020	2,643 A	2,335 E	2,446 E	2,545 E	10,033 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					$4.49 E
2020	$0.91 A	$0.91 E	$1.02 E	$1.00 E	$3.83 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 06/10/2020. The reports text is as of 06/11/2020.

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.
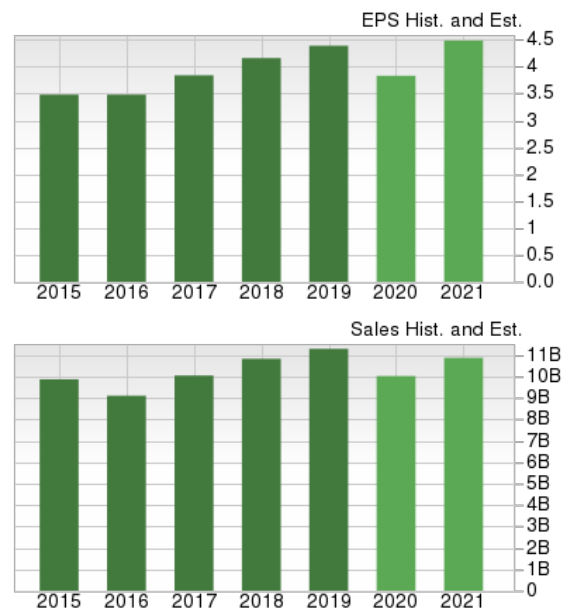
Reasons To Buy:

▲ We are positive on the improvement in operating ratio (operating expenses as a percentage of revenues) ratio in the first quarter of 2020, mainly due to low fuel costs. Adjusted operating ratio improved to 65.7% from the year-ago quarter's 69.5%. Notably, a lower value of this key metric is desirable. Moreover, accident and injury rates decreased 36% and 3% respectively. Also, fuel efficiency improved 6% in the quarter. Its policy on carbon dioxide emissions are also encouraging. We are also bullish on its performance with respect to grain transportation in March, April and May.

▲ 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.

▲ 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. Despite the crisis, its decision to maintain dividend payment is encouraging. The company will continue to evaluate its policy on the repurchase of shares on an ongoing basis.Its ability to generate free cash flow is a positive too. Notably, the company generated free cash flow of C$573 during the first quarter of 2020 compared with the year-ago quarter's C$286 million.

Low fuel costs are supporting the bottom line at Canadian National.

Reasons To Sell:

▼ Canadian National's first-quarter 2020 revenues declined year over year primarily due to COVID-19-induced network disruptions. Overall volumes decreased 6% in the quarter due to double-digit declines in the intermodal and automotive sectors. Due to the coronavirus-led uncertainty, Canadian National withdrew its full-year guidance as well as the three-year targets it outlined in June on Investors Day 2019.

▼ Disappointing freight revenues (which account for bulk of the top line) are a concern. In first-quarter 2020, freight revenues in Metals and Minerals, Forest Products and Coal segments declined 4%, 5% and 12%, respectively. Moreover, the same declined in the Automotive segment (9%). Revenues in the Intermodal segment edged down marginally to $849 million from $850 million, reported in the year ago quarter. Continuous below-par freight revenues at the key segments might hurt the stock badly.

▼ The company's total debt to total capital ratio stood at 0.45 and 0.43 at the end of the first quarter of 2020 and at the end of the fourth quarter of 2019 respectively. The increasing total debt to total capital ratio indicates that the proportion of debt to finance the company's assets is on the rise. Moreover, cash and cash equivalents were only $755 million at the end of the March quarter, way below the short-term debt figure of $1,933 million. This implies that the company does not have enough cash to meet its short-term debt obligations.

Due to the coronavirus-led uncertainty, Canadian National withdrew its full-year guidance as well as the three-year targets it outlined in June on Investors Day 2019.

Last Earnings Report

Earnings Beat at Canadian National in Q1

Canadian National's earnings (excluding 15 cents from non-recurring items) of 91 cents per share (C$1.42) beat the Zacks Consensus Estimate by 15 cents. The bottom line increased 3.4% year over year.

Quarter Ending	03/2020
Report Date	**Apr 27, 2020**
Sales Surprise	**7.64%**
EPS Surprise	**19.74%**
Quarterly EPS	**0.91**
Annual EPS (TTM)	**4.41**

Although quarterly revenues of $2,643.3 million (C$3,545 million) surpassed the Zacks Consensus Estimate of $2,455.7 million, the same declined year over year. The downtick was primarily caused by COVID-19-induced network disruptions. Lackluster freight demand also had a negative impact on the top line. However, freight revenues, which contributed 96.6% to the top line, marginally inched up in the quarter under review.

On a year-over-year basis, freight revenues declined across all segments. Nevertheless, the same in the Petroleum and Chemicals, and Grain and Fertilizers segment increased 8% and 6%, respectively. Freight revenues in Metals and Minerals, Forest Products and Coal segments declined 4%, 5% and 12%, respectively. Moreover, the same also declined in the Automotive segment (9%).Revenues in the Intermodal segment edged down marginally to $849 million from $850 million, reported in the year ago quarter. While overall carloads declined 6% year over year, revenue ton miles (RTMs) slipped 1%. However, freight revenue per carload increased 7% in the reported quarter. Freight revenue per RTM also moved up 2%.

Segment-wise, carloads declined in the Forest Products, Intermodal and Automotive segments by 8%, 12% and 15%, respectively. The metric also dropped in the Coal by 4%. Meanwhile, the metric increased in the Petroleum and Chemicals, Metals and Minerals and Grain and Fertilizers by 3%, 3% and 1%, respectively. Operating expenses for the first quarter fell 5% to C$2,330 million, primarily owing to lower labor cost as well as depreciation and fuel expenses. Adjusted operating income increased 13% year over year to C$1,215 million. Adjusted operating ratio (defined as operating expenses as a percentage of revenues) improved to 65.7% from the year-ago quarter's 69.5%. Notably, a lower value of this key metric is desirable.

Pulls Back Guidance

Canadian National withdraws its full-year guidance as well as the three-year targets it outlined in June on Investors Day 2019, citing coronavirus-led uncertainty.

Liquidity

The company exited the year with cash and cash equivalents of C$488 million compared with the C$64 million recorded at the end of 2019. The company generated free cash flow of C$573 during the first quarter of 2020 compared with the year-ago quarter's C$286 million. Long-term debt amounted to C$12,695 million as of Mar 31, 2020 compared with C$11,866 million at 2019-end.

Maintains Dividend

The company's board maintains its quarterly dividend at C$0.575, which will be paid out on Jun 30 to shareholders of record at the close of business on Jun 9.

Recent News

Grain Transportation Update — Jun 1, 2020

Canadian National transported over $2.5 million metric tonnes (MMT) of western Canadian grain, which is more than the previous May record of $2.4 million. The company's performance was impressive in March and April as well.

New Intermodal Service Offering — May 26, 2020

Canadian National announced a new intermodal rail service between Moncton and Halifax. The railroad player will offer integrated solutions through its Moncton yard to reduce short-haul trucking in Halifax. The service will be provided through collaboration with Halifax Port Authority, stakeholders, ocean carriers and customers. The company expects this service expansion to aid growth in the Atlantic region.

Valuation

Canadian National shares are up 0.6% but down 0.6% in the year-to-date period and over the trailing 12-month period respectively. Stocks in the Zacks sub-industry and the Zacks Transportation sector are down 1.4% and 11.4% in the year-to-date period respectively. Over the past year, the Zacks sub-industry and the sector are up 0.4% but down 7% respectively.

The S&P 500 index is down 0.5% in the year-to-date period but up 11.3% and in the past year.

The stock is currently trading at 22.07X forward 12-month price-to-earnings, which compares to 19.58X for the Zacks sub-industry, 40.87X for the Zacks sector and 23.17X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.26X and as low as 13.79X, with a 5-year median of 18.17X. Our neutral recommendation indicates that the stock will perform in-line with the market. Our $96 price target reflects 23.28X 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	22.07	19.58	40.87	23.17
	5-Year High	22.26	19.58	40.87	23.17
	5-Year Low	13.79	13.46	10.48	15.23
	5-Year Median	18.17	16.74	13.29	17.49
EV/EBITDA TTM	Current	14.29	13.3	7.39	11.88
	5-Year High	20.68	31.25	11.14	12.85
	5-Year Low	8.32	7.86	5.44	8.25
	5-Year Median	13.17	12.08	7.33	10.81
P/S F12M	Current	6.21	5.71	1.25	3.6
	5-Year High	6.35	5.71	1.42	3.6
	5-Year Low	3.9	3.04	0.84	2.53
	5-Year Median	5.35	4.52	1.2	3.02

As of 06/10/2020

Industry Analysis Zacks Industry Rank: Bottom 18% (206 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
Alstom ADR **(ALSMY)**	Neutral	3
Berkshire Hathaway Inc. **(BRK.B)**	Neutral	4
Canadian Pacific Railway Limited **(CP)**	Neutral	4
CSX Corporation **(CSX)**	Neutral	3
Kansas City Southern **(KSU)**	Neutral	4
Norfolk Southern Corporation **(NSC)**	Neutral	3
Union Pacific Corporation **(UNP)**	Neutral	3
WEST JAPAN RAIL **(WJRYY)**	Underperform	5

Industry Comparison Industry: Transportation - Rail | Industry Peers

	CNI	X Industry	S&P 500	ALSMY	CSX	NSC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	A	B	C
Market Cap	64.70 B	33.93 B	22.63 B	10.75 B	56.10 B	52.13 B
# of Analysts	10	7	14	1	10	10
Dividend Yield	1.80%	1.61%	1.87%	9.69%	1.42%	1.99%
Value Score	D	-	-	A	C	C
Cash/Price	0.01	0.04	0.06	0.23	0.04	0.01
EV/EBITDA	12.99	12.10	12.91	10.30	10.95	12.10
PEG Ratio	2.41	2.77	3.07	NA	2.60	3.03
Price/Book (P/B)	4.61	3.32	3.09	2.91	4.72	3.50
Price/Cash Flow (P/CF)	14.89	12.63	12.15	13.47	12.25	12.63
P/E (F1)	22.89	22.08	22.10	19.24	20.27	21.11
Price/Sales (P/S)	5.77	4.73	2.40	NA	4.76	4.70
Earnings Yield	4.21%	4.53%	4.30%	5.20%	4.94%	4.74%
Debt/Equity	0.69	0.69	0.76	0.37	1.39	0.79
Cash Flow ($/share)	6.11	6.11	7.01	0.36	5.98	14.93
Growth Score	B	-	-	A	C	C
Hist. EPS Growth (3-5 yrs)	6.78%	11.08%	10.87%	NA	23.43%	18.67%
Proj. EPS Growth (F1/F0)	-12.73%	-11.64%	-10.71%	13.64%	-13.31%	-13.61%
Curr. Cash Flow Growth	6.26%	2.96%	5.46%	9.76%	0.86%	3.26%
Hist. Cash Flow Growth (3-5 yrs)	3.06%	5.61%	8.55%	NA	8.74%	5.66%
Current Ratio	0.76	1.03	1.29	1.08	1.73	0.90
Debt/Capital	40.96%	44.24%	44.75%	27.10%	58.09%	44.24%
Net Margin	29.76%	22.73%	10.54%	NA	27.74%	21.89%
Return on Equity	22.99%	16.49%	16.08%	NA	27.27%	18.12%
Sales/Assets	0.34	0.34	0.55	NA	0.31	0.30
Proj. Sales Growth (F1/F0)	-10.75%	-7.96%	-2.59%	3.99%	-9.84%	-11.97%
Momentum Score	A	-	-	A	B	C
Daily Price Chg	-0.75%	-1.01%	-1.68%	-0.21%	-0.50%	-1.82%
1 Week Price Chg	5.65%	6.45%	7.51%	17.77%	4.89%	8.95%
4 Week Price Chg	14.60%	14.60%	16.99%	15.35%	17.58%	14.59%
12 Week Price Chg	30.21%	41.06%	37.11%	41.06%	43.79%	44.11%
52 Week Price Chg	-0.56%	-5.36%	0.02%	2.56%	-6.31%	-5.36%
20 Day Average Volume	820,428	395,511	2,620,901	222,078	4,097,617	1,450,295
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.42%	0.00%	0.00%	0.00%	-0.22%	-1.81%
(F1) EPS Est 12 week change	-16.20%	-15.99%	-15.86%	0.00%	-13.03%	-19.20%
(Q1) EPS Est Mthly Chg	0.47%	0.00%	0.00%	NA	0.00%	-4.89%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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.

Value Score	D
Growth Score	B
Momentum Score	A
VGM Score	B

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.

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.

Disclosures