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Jan 13, 2020

Canadian National(CNI)

$91.88 (As of 01/10/20)

Price Target (6-12 Months): **$78.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 01/09/20) Prior Recommendation: Neutral	**Underperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**5-Strong Sell**
	Zacks Style Scores:	VGM:F
	Value: F | Growth: D	Momentum: C

Summary

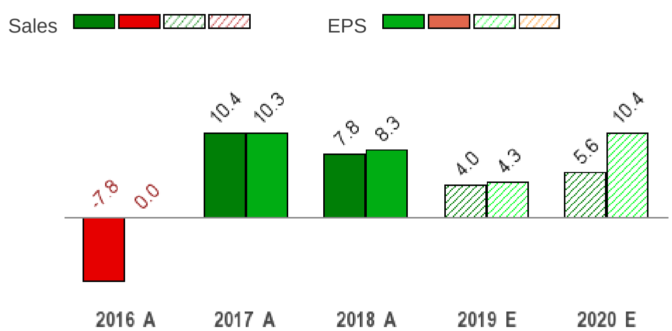
Canadian National's fourth-quarter 2019 performance is likely to have been hurt by the eight-day rail strike (Nov 19-Nov 26). Detailed results are scheduled to be out on Jan 28. In fact, the company trimmed its 2019 earnings outlook due to the above strike by its conductors and yard workers, demanding better working conditions among other things. The strike, the biggest in Canada in a decade, has dealt a further blow to the company that is already struggling due to tepid volumes. High debts are concerning as well. Due to these headwinds, shares of Canadian National have underperformed its industry in a year's time. The fact that the Zacks Consensus Estimate for 2020 earnings has been revised downward over the past 60 days highlights the negativity surrounding the stock. However, efforts to reward its shareholders are encouraging.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$96.49 - $79.40**
20 Day Average Volume (sh)	**584,973**
Market Cap	**$65.7 B**
YTD Price Change	**1.6%**
Beta	**1.00**
Dividend / Div Yld	**$1.62 / 1.8%**
Industry	**Transportation - Rail**
Zacks Industry Rank	**Bottom 11% (226 out of 254)**
Last EPS Surprise	**3.3%**
Last Sales Surprise	**-1.3%**
EPS F1 Est- 4 week change	**-3.4%**
Expected Report Date	**01/28/2020**
Earnings ESP	**1.8%**
P/E TTM	**20.2**
P/E F1	**19.2**
PEG F1	**1.8**
P/S TTM	**5.8**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	2,801 E	3,113 E	3,091 E	2,996 E	11,900 E
2019	2,666 A	2,960 A	2,901 A	2,730 E	11,268 E
2018	2,521 A	2,814 A	2,822 A	2,882 A	10,837 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	$0.94 E	$1.39 E	$1.36 E	$1.18 E	$4.79 E
2019	$0.88 A	$1.29 A	$1.26 A	$0.89 E	$4.34 E
2018	$0.79 A	$1.17 A	$1.15 A	$1.13 A	$4.16 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 01/10/2020. The reports text is as of 01/13/2020.

Overview

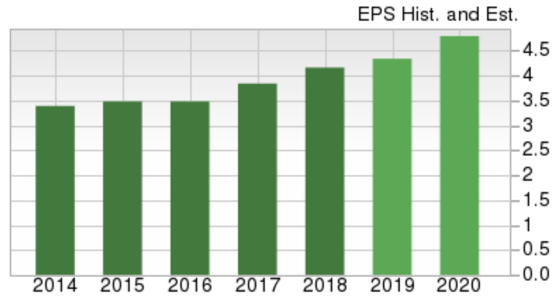
Based in Montreal, Canada, Canadian National Railway Company is engaged in the rail and related transportation business. It operates as the largest rail network in Canada and the only transcontinental network in North America. The company's rail network serves major Canadian ports and includes connections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

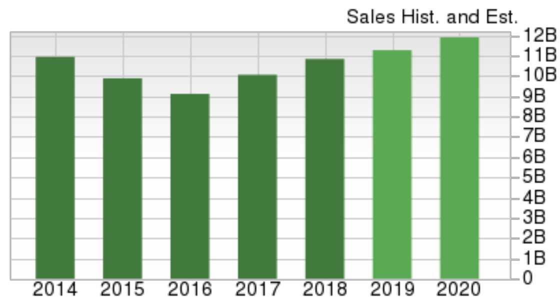
The company was founded in 1919. It is responsible for transporting more than C$250 billion worth of goods annually for a wide range of business sectors, ranging from resource products to manufactured products to consumer goods, across a vast rail network.

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 94.6% of 2018 revenues) and other sources (5.4%). 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:





- **Petroleum and Chemicals** (accounted for 19.6% of 2018 rail freight revenues) comprises commodities, including chemicals, sulfur, plastics, petroleum products and liquefied petroleum gas (LPG) products.

- **Metals and Minerals** (12.5%) consists of nonferrous metals, concentrates, iron ore, steel, aluminum, construction materials, machinery and dimensional loads.

- **Forest Products** (13.9%) includes various types of lumber, panels, paper, wood pulp and other fibers, such as logs, recycled paper and wood chips.

- **Coal** (4.9%) consists of thermal grades of bituminous coal. It also includes the transport of Canadian metallurgical coal.

- **Grains and Fertilizers** (17.4%) comprises three primary segments: food grains, feed grains, oilseeds and oilseed products.

Reasons To Sell:

- Canadian National's fourth-quarter 2019 performance is likely to have been hurt by the eight-day rail strike (Nov 19-Nov 26). Detailed results are scheduled to be releon Jan 28. The strike by the company's conductors and yard workers, demanding better working conditions among other things, resulted in shipment delays and prompted the company to trim its 2019 earnings outlook. Expecting the work stoppage to have dented earnings per share to the tune of C$0.15, Canadian National anticipates 2019 adjusted earnings per share to have grown in low to mid-single digits compared with the previous forecast of a rise in the high single-digit range. The company's adjusted earnings were C$5.50 per share last year.

Canadian National trimmed its adjusted EPS growth target for 2019, citing shipment delays due to the rail strike.

- Softness in the global economy is hurting volumes at Canadian National. While trade-related uncertainty is affecting international intermodal volumes, weakness in the manufacturing sector is impacting domestic intermodal volumes. Additionally, slowdown in drilling activity in Western Canada is marring sand revenues and the situation is unlikely to improve until the second half of 2020.

- Although the company's capital investments are for long-term benefits, the same is affecting free cash flow in the short term. Notably, free cash flow at the end of the first nine months of 2019 was $1.5 billion, which was $382 million lower than that at the end of the same period a year ago. The company's high debt levels are also a cause for concern. As of Sep 30, 2019, long-term debt increased to C$11,587 million compared with C$11,385 million in December 2018.

Risks

- Despite economic downturn, Canadian National is benefiting from higher freight revenues, which account for the bulk of its top line. Notably, rail freight revenues increased 8% in the first nine months of 2019. We expect this trend to have continued in the fourth quarter. Amid sluggish market conditions, the company's cost-control measures are appreciative too. Evidently, operating expenses increased a mere 1% in the third quarter after having risen 14% and 8% during the first and second quarters, respectively. Consequently, the improvement in the operating ratio (defined as operating expenses as a percentage of revenues) holds promise. This key measure of efficiency improved in the first nine months of 2019. Notably, lower the value of the metric, the better.

- We are impressed by the company's efforts to improve rail infrastructure and increase capacity. To this end, it incurred capital expenditures in excess of C$3.5 billion in 2018. The same is projected to be around C$3.9 billion in 2019. Bulk of the expenditures will be toward renewal of a more efficient and reliable locomotive fleet. Additionally, the company's buyout of The TransX Group of Companies bolsters its supply chain and intermodal businesses across North America.

- The company's efforts to reward shareholders through dividend payments and share buybacks also raise optimism. The company has raised dividends consecutively for 23 years. The latest hike was announced in January 2019, when the company's board of directors approved an 18% hike in its quarterly cash dividend to C$0.5375 per share. As far as buybacks are concerned, Canadian National has bought back shares worth $1.27 billion during the first nine months of 2019.

Last Earnings Report

Earnings Beat at Canadian National in Q3

Quarter Ending	09/2019
Report Date	Oct 22, 2019
Sales Surprise	-1.26%
EPS Surprise	3.28%
Quarterly EPS	1.26
Annual EPS (TTM)	4.56

Canadian National's third-quarter earnings of $1.26 per share (C$1.66) beat the Zacks Consensus Estimate of $1.22. The bottom line also improved year over year.

Although quarterly revenues of $2,901.1 million (C$3,830 million) increased year over year, the same missed the Zacks Consensus Estimate of $2,938 million. Higher freight rates and Intermodal revenues drove the top line. Also, freight revenues climbed 4% year over year and contributed 94.5% to the top line.

Operating Results

On a year-over-year basis, freight revenues rose in Petroleum and Chemicals (18%), Intermodal (13%) and Automotive (9%). Meanwhile, the same declined in Metals and Minerals (7%), Forest Products (11%), Coal (1%) as well as Grain and Fertilizers (3%). While overall carloads were flat year over year, revenue ton miles (RTMs) dipped 1%. However, freight revenue per carload ascended 4% in the quarter under review. Freight revenue per RTM also increased 6%.

The Petroleum and Chemicals as well as Automotive sub-group performed impressively with respect to carloads with the metric increasing 10% each. At the Metals and Minerals plus Intermodal segments, the same inched up 1% each. While Coal volumes were unchanged year over year, Forest Products and Grain and Fertilizers volumes declined 14% and 7%, respectively.

Adjusted operating income augmented 8.1% year over year to C$1613 million. Adjusted operating ratio (defined as operating expenses as a percentage of revenues) improved to 57.9% from 59.5% in the year-ago quarter. Notably, lower value of this key metric bodes well for the company.

However, operating expenses inched up 1% year over year to C$2,217 million, primarily due to higher purchased services and material expense plus higher depreciation and amortization costs.

Liquidity

The company exited the third quarter with cash and cash equivalents of C$258 million compared with C$266 million at the end of 2018. Free cash flow came in at C$700 compared with C$585 million in the year-ago period. Long-term debt amounted to C$11,587 million as of Sep 30, 2019 compared with C$11,385 million in December 2018.

Dividend Update

The company’s board has declared a quarterly cash dividend of C$0.5375 per share payable Dec 30, 2019 to shareholders of record as of Dec 9.

Outlook

Due to fall in North American rail demand as a result of weak economy, the company now anticipates 2019 adjusted earnings per share to grow in high single-digit range compared with C$5.50 reported in 2018. Previously, the same was expected to rise in the low double-digit band. RTMs are expected to witness slightly negative volume growth in the current year compared with the earlier prediction of a mid-single-digit volume expansion.

Recent News

Bleak Earnings View for 2019 — Dec 3, 2019

Canadian National lowered its outlook for 2019 earnings as the eight-day strike significantly affected operations, forcing it to run on a capacity of only 10%. Expecting the work stoppage to have dented earnings per share to the tune of C$0.15, Canadian National anticipates 2019 adjusted earnings per share to grow in low to mid-single digits compared with the previous forecast of a rise in the high single-digit range. The company's adjusted earnings were C$5.50 per share in 2018.

The eight-day industrial action at Canadian National began on Nov 19 with workers agitating over safety issues, working conditions including time to take a break and benefits.

Tentative Deal with Teamsters — Nov 27, 2019

Canadian National reached a tentative deal with the labor union representing 3,200 conductors and yard crews, ending the eight-day long strike. The deadlock wreaked havoc on the Canadian economy, which was already struggling on the agriculture front due to poor harvest conditions and the U.S.-China trade dispute.

Following the agreement on Nov 26, operations at Canadian National resumed on Nov 27. Terms of the agreement between the company and the labor union, Teamsters Canada Rail Conference, were kept under wraps. The union said that the agreement needs to be ratified by Teamsters members through secret-ballot electronic voting, the results of which are expected in eight weeks.

With the cessation of the strike, the labor union Unifor stated that the notices which they received regarding the layoff of 70 workers in Halifax have been revoked.

Valuation

Canadian National shares are up 12.7% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Zacks Transportation sector are up 17.2% and 11.5% respectively.

The S&P 500 index is up 25.6% over the past year.

The stock is currently trading at 19.1X forward 12-month price-to-earnings, which compares to 17.34X for the Zacks sub-industry, 12.99X for the Zacks sector and 18.88X 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 18.17X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our $78 price target reflects 16.21X 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 F12M	Current	19.1	17.34	12.99	18.88
	5-Year High	21.35	19.35	16.98	19.34
	5-Year Low	13.79	13.46	10.46	15.17
	5-Year Median	18.17	16.68	13.1	17.44
P/B TTM	Current	4.69	5.44	3.26	4.46
	5-Year High	5.63	5.76	4.67	4.47
	5-Year Low	3.21	2.21	2.68	2.85
	5-Year Median	4.57	4.39	3.42	3.61
P/S F12M	Current	5.51	5.31	1.13	3.5
	5-Year High	6.35	5.31	1.44	3.5
	5-Year Low	3.9	3.04	1.03	2.54
	5-Year Median	5.31	4.43	1.23	3

As of 01/10/2020

Industry Analysis Zacks Industry Rank: Bottom 11% (226 out of 254)

Top Peers

Berkshire Hathaway Inc. **(BRK.B)**	Neutral
Canadian Pacific Railway Limited **(CP)**	Neutral
CSX Corporation **(CSX)**	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

Industry Comparison Industry: Transportation - Rail

Industry Peers

	CNI Underperform	X Industry	S&P 500	CP Neutral	KSU Neutral	NSC Neutral
VGM Score	F	-	-	C	C	D
Market Cap	65.73 B	25.94 B	24.03 B	35.40 B	15.69 B	51.51 B
# of Analysts	9	7	13	8	6	4
Dividend Yield	1.77%	1.68%	1.78%	0.98%	1.01%	1.90%
Value Score	F	-	-	D	D	D
Cash/Price	0.01	0.04	0.04	0.00	0.00	0.01
EV/EBITDA	12.83	12.11	14.04	14.42	13.42	12.11
PEG Ratio	1.81	1.85	2.02	1.70	1.33	1.81
Price/Book (P/B)	4.69	3.38	3.32	6.54	3.02	3.38
Price/Cash Flow (P/CF)	16.32	14.27	13.52	16.94	16.69	14.27
P/E (F1)	19.18	18.09	18.82	18.51	19.94	17.66
Price/Sales (P/S)	5.76	4.60	2.63	6.08	5.54	4.48
Earnings Yield	5.21%	5.53%	5.31%	5.40%	5.02%	5.66%
Debt/Equity	0.65	0.73	0.72	1.15	0.46	0.73
Cash Flow ($/share)	5.63	5.67	6.94	15.23	9.48	13.84
Growth Score	D	-	-	C	B	C
Hist. EPS Growth (3-5 yrs)	6.26%	9.54%	10.56%	10.01%	7.95%	14.51%
Proj. EPS Growth (F1/F0)	10.50%	11.23%	7.49%	12.00%	14.86%	11.14%
Curr. Cash Flow Growth	4.94%	8.45%	14.83%	19.36%	9.74%	26.47%
Hist. Cash Flow Growth (3-5 yrs)	4.63%	6.34%	9.00%	6.46%	7.63%	6.34%
Current Ratio	0.71	0.89	1.23	0.57	0.78	0.73
Debt/Capital	39.33%	42.11%	42.99%	53.52%	31.54%	42.11%
Net Margin	29.62%	23.75%	11.08%	30.02%	20.23%	23.98%
Return on Equity	24.36%	15.63%	17.16%	32.62%	13.03%	18.22%
Sales/Assets	0.35	0.35	0.55	0.35	0.29	0.31
Proj. Sales Growth (F1/F0)	5.61%	4.51%	4.20%	6.69%	5.39%	1.58%
Momentum Score	C	-	-	A	B	F
Daily Price Chg	-0.17%	-0.45%	-0.33%	0.07%	-1.04%	-0.38%
1 Week Price Chg	0.30%	0.13%	-0.30%	0.20%	0.50%	0.64%
4 Week Price Chg	1.39%	1.52%	1.71%	3.27%	4.21%	3.70%
12 Week Price Chg	4.90%	5.01%	6.05%	18.59%	16.86%	7.53%
52 Week Price Chg	14.42%	15.10%	22.39%	35.77%	54.44%	22.39%
20 Day Average Volume	584,973	167,033	1,580,816	295,598	868,845	1,256,977
(F1) EPS Est 1 week change	-1.19%	-0.05%	0.00%	0.06%	0.07%	-0.20%
(F1) EPS Est 4 week change	-3.35%	-0.72%	0.00%	0.33%	-0.35%	-1.09%
(F1) EPS Est 12 week change	-7.37%	-2.43%	-0.50%	-0.15%	3.15%	-2.70%
(Q1) EPS Est Mthly Chg	-4.08%	-3.16%	0.00%	5.51%	2.29%	-2.88%

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.

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	F
Growth Score	D
Momentum Score	C
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.

Disclosures

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