

Canadian National(CNI)

\$105.82 (As of 08/21/20)

Price Target (6-12 Months): **\$111.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 08/21/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: C

Growth: C

Momentum: F

Summary

Canadian National is being aided by shipments of higher volumes of grains. Notably, revenues in the Grain and Fertilizers segment increased 1%. In fact, the company moved a record 15 million metric tonnes (MMT) of Canadian grain in the first half of the year. We are also positive about the company's buyout of TransX, which contributed to its supply chain and intermodal businesses across North America. The company's efforts to reward its shareholders despite adversities are an added boon. Strong free cash flow generation (up 97.8% in first-half 2020) supports shareholder-friendly activities. However, decline in freight revenues, mainly due to coronavirus-induced weak volumes, is concerning. Deterioration in the operating ratio due to high operating expenses is an added bane. The company's liquidity position is also worrisome.

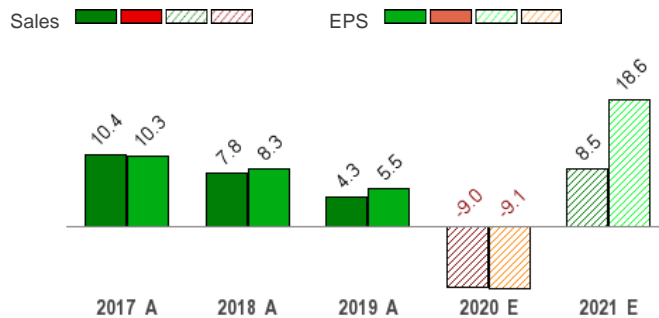
Price, Consensus & Surprise



Data Overview

| | |
|----------------------------|---------------------------------------|
| 52 Week High-Low | \$106.02 - \$65.13 |
| 20 Day Average Volume (sh) | 899,216 |
| Market Cap | \$75.1 B |
| YTD Price Change | 17.0% |
| Beta | 0.90 |
| Dividend / Div Yld | \$1.71 / 1.6% |
| Industry | Transportation - Rail |
| Zacks Industry Rank | Top 37% (93 out of 252) |

Sales and EPS Growth Rates (Y/Y %)



| | |
|---------------------------|--------------|
| Last EPS Surprise | 0.0% |
| Last Sales Surprise | -3.9% |
| EPS F1 Est- 4 week change | 0.7% |
| Expected Report Date | NA |
| Earnings ESP | -0.2% |
| P/E TTM | 26.2 |
| P/E F1 | 26.5 |
| PEG F1 | 3.8 |
| P/S TTM | 7.1 |

Sales Estimates (millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|---------|---------|---------|---------|----------|
| 2021 | | | | | 11,157 E |
| 2020 | 2,643 A | 2,315 A | 2,579 E | 2,652 E | 10,282 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 | | | | | \$4.73 E |
| 2020 | \$0.91 A | \$0.92 A | \$1.06 E | \$1.06 E | \$3.99 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 08/21/2020. The reports text is as of 08/24/2020.

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.

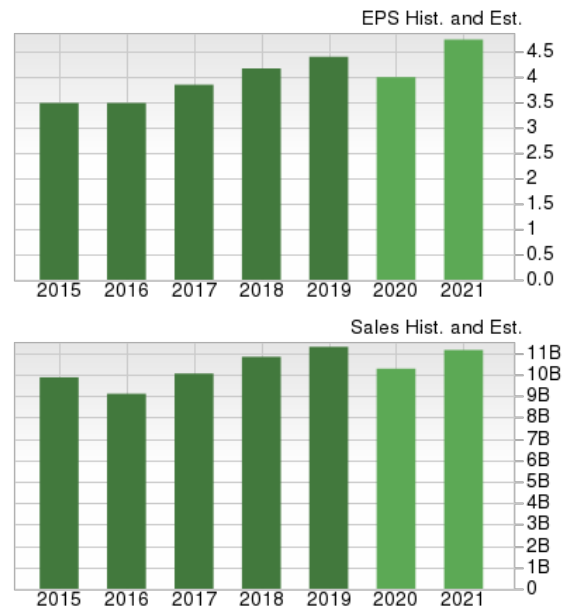
The company was founded in 1919. It is responsible for transporting more than C\$250 billion worth of goods annually for a wide range of business sectors, ranging from resource products to manufactured products to consumer goods, across a vast rail network.

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:

- **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 performance of Canadian National with respect to grain transportation in March, April, May and June. Notably, the company moved 15 million metric tonnes (MMT) of Canadian grain in the first half of the year, thereby bettering its previous record of 13.9 MMT. Also, Canadian National set a record by moving 8.15MMT of Canadian grain during second-quarter 2020. With this, the company also broke its previously set record of moving 8.08 MMT Canadian grains. Notably, revenues in the Grain and Fertilizers segment inched up 2% in first-half 2020. The company moved more than 30 million MMT of grain from across Canada during the 2019-2020 crop year, which is a record.

We are positive on the performance of Canadian National with respect to grain transportation in the first half of 2020.

▲ 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, the company's new intermodal rail service between Moncton and Halifax (announced in May) is expected to aid growth in the Atlantic region. Canadian National aims to improve efficiency within supply chains, through this initiative.

▲ 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. Its ability to generate free cash flow is a positive too. Notably, the company generated free cash flow of C\$1,581 million during first-half 2020 compared with the year-ago period's figure of C\$799 million.

Reasons To Sell:

- ▼ Canadian National's first-half 2020 revenues declined 10% year over year primarily due to COVID-19-induced network disruptions. Freight revenues in the Metals and Minerals, Forest Products and Coal segments declined 18%, 12% and 17%, respectively, in the first six months of 2020. Moreover, the same plunged 43% in the Automotive segment. Revenues in the Intermodal segment edged down 6%. Continuous below-par freight revenues at the key segments might hurt the stock badly. Overall volumes decreased 11% in the first half of 2020 due to double-digit declines in key segments like intermodal and automotive sectors. The company's third-quarter performance is also likely to reflect substantial volume softness.
- ▼ Deterioration in operating ratio (operating expenses as a % of revenues) despite tepid revenues is concerning. This key metric has deteriorated to 70.4% in first-half 2020 from 63.2% in first-half 2019, mainly due to high operating expenses as revenues are weak. On an adjusted basis, the metric deteriorated to 63.2% in the first six months of 2020 from 62.1%. Notably, a lower value of the metric is more desirable.
- ▼ The company exited the June quarter with cash and cash equivalents of C\$375 million, less than the current portion of long-term debt of C\$1,055 million. This implies that the company does not have enough cash to meet its current debt obligations. Moreover, the company's current ratio (a measure of liquidity) of 0.97 is less than its industry's 1.14.

Disappointing freight revenues (which account for bulk of the top line) are a concern.

Last Earnings Report

Canadian National's Revenue Miss in Q2

Canadian National's earnings (excluding 36 cents from non-recurring items) of 92 cents per share (C\$0.77) meet the Zacks Consensus Estimate. However, the bottom line declined 28.7% year over year.

Quarterly revenues of \$2,315 million (C\$3,209 million) missed the Zacks Consensus Estimate of \$2,407.6 million and declined 21.8% year over year. The downtick was primarily caused by COVID-19-induced lower volumes across most commodity groups and lower fuel surcharge rates.

Lackluster freight demand also had a negative impact on the top line. Freight revenues, which contributed 94.7% to the top line, fell 19.2% year over year. On a year-over-year basis, freight revenues declined across all segments. Freight revenues in Petroleum and Chemicals, Metals and Minerals, Forest Products and Coal segment declined 25%, 30%, 15% and 21%, respectively. Moreover, the same also declined in the Automotive (72%) and Intermodal segment (12%). Nevertheless, revenues in the Grain and Fertilizers segment inched up 1%.

While overall carloads declined 15.9% year over year, revenue ton miles (RTMs) slipped 18.4%. Segment-wise, carloads declined in the Petroleum and Chemicals, Metals and Minerals, Forest Products, Coal and Grain and Fertilizers segment by 25%, 19%, 17%, 21% and 3%, respectively. The metric also fell in the Automotive and Intermodal segment by 72% and 8%, respectively. Moreover, freight revenue per carload dropped 3.9% in the reported quarter. Freight revenue per RTM also fell 1%.

Operating expenses for the second quarter rose 6% to C\$2,424 million, primarily due to loss on assets held for sale. Adjusted operating income declined 24% year over year to C\$1,271 million. Adjusted operating ratio (defined as operating expenses as a percentage of revenues) deteriorated to 60.4% from the year-ago quarter's figure of 57.5%. Notably, a smaller value of the metric is desirable.

Liquidity

The company exited the June end quarter with cash and cash equivalents of C\$375 million compared with the C\$64 million recorded at the end of 2019. The company generated free cash flow of C\$1,008 during the second quarter of 2020 compared with the year-ago quarter's C\$513 million. Long-term debt amounted to C\$13,107 million as of Jun 30, 2020 compared with C\$11,866 million at 2019-end.

Quarter Ending 06/2020

| Report Date | Jul 21, 2020 |
|------------------|--------------|
| Sales Surprise | -3.85% |
| EPS Surprise | 0.00% |
| Quarterly EPS | 0.92 |
| Annual EPS (TTM) | 4.04 |

Recent News

Dividend Update — Jul 21, 2020

The company's board approved the regular quarterly dividend at C\$0.575. The amount will be paid on Sep 30 to its shareholders of record at the close of business on Sep 9.

Update on Grain Movement — Jul 07, 2020

Canadian National achieved another monthly record in June by moving 2.7 MMT of Canadian grain. With this, the company has broken its previous June record of moving 2.4 MMT Canadian grains.

June has been the fourth consecutive month of record grain movement, contributing significantly to Canadian National's record with respect to the grain movement in the first six months of the year. Notably, the Canadian railroad operator moved 15 MMT of Canadian grain in the first half of the year, thereby bettering its previous record of 13.9 MMT. Also, Canadian National set a record by moving 8.15MMT of Canadian grain during second-quarter 2020. With this, the company also broke its previously set record of moving 8.08MMT Canadian grains.

Valuation

Canadian National shares are up 17% and 17.1% in the year-to-date period and over the trailing 12-month period respectively. Stocks in the Zacks sub-industry are up 9.2% and those in the Zacks Transportation sector are down 0.6% in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 20.4% and 9.4%, respectively.

The S&P 500 index is up 5.4% in the year-to-date period and 18.3% in the past year.

The stock is currently trading at 23.69X forward 12-month price-to-earnings, which compares to 20.53X for the Zacks sub-industry, 29.26X for the Zacks sector and 22.85X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.75X and as low as 13.79X, with a 5-year median of 18.29X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$111 price target reflects 24.85X forward 12-month earnings.

The table below shows summary valuation data for CN

| Valuation Multiples - CN | | | | | |
|--------------------------|---------------|-------|--------------|--------|---------|
| | | Stock | Sub-Industry | Sector | S&P 500 |
| P/E F12M | Current | 23.69 | 20.53 | 29.26 | 22.85 |
| | 5-Year High | 23.75 | 20.53 | 31.58 | 22.85 |
| | 5-Year Low | 13.79 | 13.46 | 10.49 | 15.25 |
| | 5-Year Median | 18.29 | 16.88 | 13.5 | 17.58 |
| EV/EBITDA TTM | Current | 17.14 | 15.26 | 10.01 | 12.89 |
| | 5-Year High | 20.68 | 31.25 | 11.09 | 12.89 |
| | 5-Year Low | 8.32 | 7.86 | 5.38 | 8.25 |
| | 5-Year Median | 13.41 | 12.29 | 7.25 | 10.91 |
| P/S F 12M | Current | 6.93 | 6.25 | 1.35 | 3.71 |
| | 5-Year High | 6.93 | 6.25 | 1.41 | 3.71 |
| | 5-Year Low | 3.9 | 3.04 | 0.85 | 2.53 |
| | 5-Year Median | 5.4 | 4.59 | 1.2 | 3.05 |

As of 08/21/2020

Industry Analysis Zacks Industry Rank: Top 37% (93 out of 252)



Top Peers

| Company (Ticker) | Rec | Rank |
|---------------------------------------|------------|------|
| Canadian Pacific Railway Limited (CP) | Outperform | 2 |
| United Parcel Service, Inc. (UPS) | Outperform | 1 |
| Central Japan Railway Co. (CJPRY) | Neutral | 3 |
| CSX Corporation (CSX) | Neutral | 3 |
| Kansas City Southern (KSU) | Neutral | 3 |
| Norfolk Southern Corporation (NSC) | Neutral | 3 |
| Union Pacific Corporation (UNP) | Neutral | 3 |
| WEST JAPAN RAIL (WJRY) | Neutral | 3 |

| Industry Comparison Industry: Transportation - Rail | | | | Industry Peers | | |
|---|---------|------------|-----------|----------------|-----------|-----------|
| | CNI | X Industry | S&P 500 | CP | CSX | NSC |
| Zacks Recommendation (Long Term) | Neutral | - | - | Outperform | Neutral | Neutral |
| Zacks Rank (Short Term) | 3 | - | - | 2 | 3 | 3 |
| VGM Score | D | - | - | D | C | D |
| Market Cap | 75.12 B | 22.37 B | 23.62 B | 40.48 B | 56.71 B | 57.55 B |
| # of Analysts | 10 | 7 | 14 | 10 | 10 | 10 |
| Dividend Yield | 1.55% | 1.55% | 1.65% | 0.82% | 1.40% | 1.80% |
| Value Score | C | - | - | C | C | C |
| Cash/Price | 0.01 | 0.05 | 0.07 | 0.01 | 0.05 | 0.02 |
| EV/EBITDA | 14.79 | 12.68 | 13.29 | 14.54 | 10.97 | 13.19 |
| PEG Ratio | 3.80 | 2.82 | 3.03 | 2.87 | 2.77 | 3.33 |
| Price/Book (P/B) | 5.55 | 3.76 | 3.11 | 7.52 | 4.66 | 3.87 |
| Price/Cash Flow (P/CF) | 17.32 | 13.99 | 12.69 | 18.13 | 12.39 | 13.99 |
| P/E (F1) | 26.52 | 24.57 | 21.51 | 22.96 | 21.06 | 23.72 |
| Price/Sales (P/S) | 7.10 | 5.40 | 2.43 | 6.89 | 5.17 | 5.62 |
| Earnings Yield | 3.77% | 3.92% | 4.46% | 4.36% | 4.75% | 4.22% |
| Debt/Equity | 0.70 | 0.81 | 0.76 | 1.27 | 1.33 | 0.85 |
| Cash Flow (\$/share) | 6.11 | 6.11 | 6.93 | 16.48 | 5.98 | 14.93 |
| Growth Score | C | - | - | D | D | D |
| Hist. EPS Growth (3-5 yrs) | 6.34% | 12.62% | 10.44% | 14.04% | 23.81% | 18.89% |
| Proj. EPS Growth (F1/F0) | -9.16% | -10.88% | -5.53% | 5.00% | -15.59% | -14.83% |
| Curr. Cash Flow Growth | 6.26% | 1.21% | 5.20% | 5.41% | 0.86% | 3.26% |
| Hist. Cash Flow Growth (3-5 yrs) | 3.06% | 5.61% | 8.52% | 5.60% | 8.74% | 5.66% |
| Current Ratio | 0.97 | 1.08 | 1.33 | 0.81 | 1.62 | 1.21 |
| Debt/Capital | 41.11% | 45.91% | 44.50% | 55.89% | 57.01% | 45.91% |
| Net Margin | 25.66% | 20.55% | 10.13% | 29.48% | 26.39% | 20.47% |
| Return on Equity | 20.92% | 18.49% | 14.67% | 34.28% | 24.24% | 16.06% |
| Sales/Assets | 0.32 | 0.32 | 0.51 | 0.34 | 0.28 | 0.27 |
| Proj. Sales Growth (F1/F0) | -8.54% | -8.54% | -1.54% | -2.01% | -11.84% | -13.14% |
| Momentum Score | F | - | - | D | C | C |
| Daily Price Chg | 0.79% | 0.23% | -0.15% | 0.16% | 0.30% | 1.31% |
| 1 Week Price Chg | 2.40% | 3.11% | 1.09% | 4.14% | 1.81% | 3.83% |
| 4 Week Price Chg | 10.37% | 7.65% | 1.64% | 8.65% | 3.63% | 11.74% |
| 12 Week Price Chg | 22.49% | 12.35% | 6.72% | 18.95% | 4.04% | 15.90% |
| 52 Week Price Chg | 15.22% | 15.22% | 1.00% | 24.29% | 12.08% | 20.22% |
| 20 Day Average Volume | 899,216 | 258,243 | 1,873,576 | 346,069 | 3,193,951 | 1,351,370 |
| (F1) EPS Est 1 week change | 0.00% | 0.00% | 0.00% | 0.00% | 0.17% | -0.10% |
| (F1) EPS Est 4 week change | 0.71% | 0.35% | 1.79% | 4.59% | -0.65% | 1.31% |
| (F1) EPS Est 12 week change | 4.47% | -1.54% | 3.35% | 11.05% | -2.63% | -1.41% |
| (Q1) EPS Est Mthly Chg | -1.67% | 0.89% | 0.42% | 1.39% | 3.88% | 0.89% |

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.

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 | C |
| Growth Score | C |
| Momentum Score | F |
| VGM Score | D |

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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