Canadian National Railway (CNI)

Updated May 2nd, 2022 by Nathan Parsh

Key Metrics

Current Price:	$118	**5 Year CAGR Estimate:**	5.6%	**Market Cap:**	$81 B
Fair Value Price:	$100	**5 Year Growth Estimate:**	7.0%	**Ex-Dividend Date:**	06/08/22
% Fair Value:	117%	**5 Year Valuation Multiple Estimate:**	-3.2%	**Dividend Payment Date:**	06/30/22
Dividend Yield:	1.9%	**5 Year Price Target**	$141	**Years Of Dividend Growth:**	27
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Rating:**	Hold

Overview & Current Events

Canadian National Railway is the largest railway operator in Canada. The company has a network of approximately 20,000 route miles and connects three coasts: the Atlantic, the Pacific and the Gulf of Mexico. It handles over $200 billion worth of goods annually and carries over 300 million tons of cargo. The company is cross-listed on the New York Stock Exchange, where it trades under the ticker CNI. Although the company reports financial results in Canadian Dollars, all figures in this report are in USD, as the railroad's NYSE-listed shares have been used for the purpose of valuation analysis.

On January 25th, 2022, Canadian National Railway increased its dividend 19.8% for the March 31st, 2022 payment date.

On April 26th, 2022, Canadian National Railway announced first quarter results for the period ending March 31st, 2022. Revenue grew 1.5% to $2.89 billion, beating estimates by $9.1 million. Adjusted earnings-per-share of $1.03 compared to $0.99 in the prior year, but was $0.06 lower than expected.

Due to a challenging operating environment, Canadian National Railway's operating ratio was higher by 440 basis points to 66.6%. Revenue ton miles grew 5% during the quarter, considerably better than the 10.5% decrease that the company experienced in the fourth quarter of 2021. Grain and fertilizers volumes were down 18% while revenues fell 15% following another very difficult comparable period. Intermodal volume was down 13%, which was a slight improvement on a sequential basis, while revenue grew 9% due to better pricing. Petroleum and Chemical carloads increased 6%, with revenues up 14%. Metals and minerals carloads decreased 6%, though better prices led to 10% revenue growth. Revenue for Forest Products were down 1% as an increase in price wasn't enough to offset a volume decline. Coal revenue was up 55% on the strength of increased demand. Revenue for Automotive was up 4% though volume remains down due to the ongoing semiconductor chip shortage.

Canadian National Railway lowered its adjusted earnings-per-share growth forecast to 15% to 20% for the year, down from 20% previously, due to operating environment headwinds. We have updated our forecast accordingly.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$2.84	$2.88	$3.23	$3.20	$3.44	$3.82	$4.31	$4.41	$4.00	$4.75	*$5.58*	*$7.83*
DPS	$0.76	$0.81	$0.86	$0.90	$1.12	$1.25	$1.39	$1.62	$1.64	$1.96	*$2.28*	*$3.20*
Shares[1]	857	831	809	787	762	743	735	717	711	701	*700*	*675*

Canadian National Railway has grown its earnings at an approximately 6% average annual rate during the last decade, but it has slowed to a 4.4% annual growth rate in the last five years. Still, we believe that the company is capable of delivering more than 6% growth moving forward. More specifically, we are forecasting 7% long-term growth in per-share earnings for company due to increased revenues and share repurchases. Applying a 7% growth rate to our 2022 earnings-per-share estimate of $5.58 allows us to compute a 2027 per-share-earnings estimate of $7.83.

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[1] Share count in millions

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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	14.9	17.6	19.6	19.2	17.8	20.1	19.1	20.0	23.6	25.9	*21.1*	*18.0*
Avg. Yld.	1.8%	1.6%	1.4%	1.5%	1.8%	1.6%	1.7%	1.8%	1.8%	1.6%	*1.9%*	*2.3%*

Shares of Canadian National Railway have decreased $4, or 3.3%, since our January 26th, 2022 report. The stock has traded at an average price-to-earnings ratio of 19.8 over the last decade, but is trading at just above 21 times earnings estimates for the year. We are reaffirming our target price-to-earnings ratio of 18 as this better reflects the average valuation over the last decade. If Canadian National Railway's price-to-earnings ratio contracts to this target then annual returns would be reduced by 3.2% over this period. We see the stock as overvalued today at 117% of fair value.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	27%	28%	27%	28%	33%	33%	32%	37%	41%	41%	*41%*	*41%*

Canadian National Railway benefits from operating in the railway industry, one of the sectors with the highest barriers to entry. The capital and expertise required to build new railways is tremendous. Moreover, the railway industry is saturated and is structured as an oligopoly, which results in virtually no new entrants and minimal competition. Canadian National Railway is also quite shareholder-friendly, as the company has increased its dividend payment (in Canadian dollars) for 27 consecutive years.

Final Thoughts & Recommendation

After first quarter results, Canadian National Railway is now expected to offer a total annual return of 5.6% through 2027, up from our previous estimate of 1.8%. This projection stems from a 7% earnings growth rate and starting yield of 1.9% that are offset by a low single-digit headwind from multiple contraction. Canadian National Railway saw strong results in most areas of its business, though the sizeable increase in the operating ratio is something to monitor going forward. We now view shares of Canadian National Railway as a hold due to projected returns.

Total Return Breakdown by Year
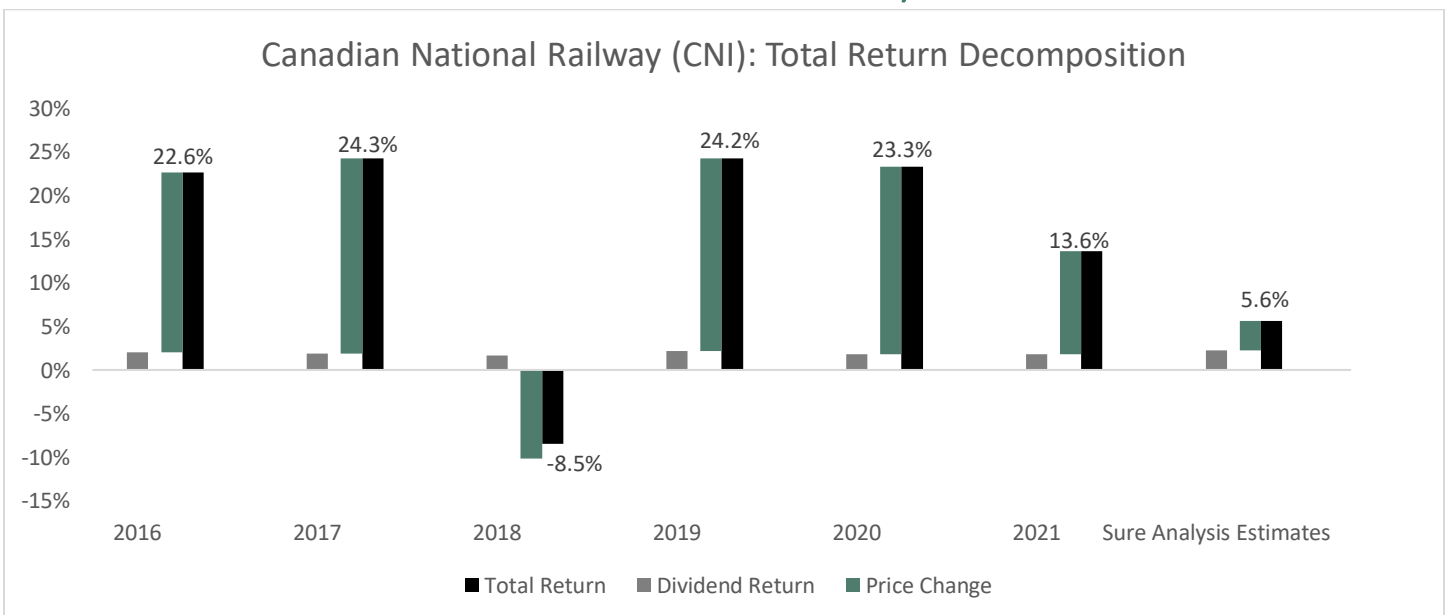
Canadian National Railway (CNI): Total Return Decomposition

■ Total Return ■ Dividend Return ■ Price Change

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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	9923	10270	10991	9881	9089	10063	11051	11239	10314	11547
Gross Profit	4024	4048	4522	4435	4074	4379	4601	4585	4307	4841
Gross Margin	40.6%	39.4%	41.1%	44.9%	44.8%	43.5%	41.6%	40.8%	41.8%	41.9%
D&A Exp.	924	952	951	907	925	988	1026	1177	1186	1275
Operating Profit	4024	4048	4522	4435	4074	4379	-2212	-2440	-2441	4841
Operating Margin	40.6%	39.4%	41.1%	44.9%	44.8%	43.5%	-20.0%	-21.7%	-23.7%	41.9%
Net Profit	2681	2537	2869	2772	2749	4231	3340	3177	2659	3902
Net Margin	27.0%	24.7%	26.1%	28.1%	30.2%	42.1%	30.2%	28.3%	25.8%	33.8%
Free Cash Flow	1329	1530	1888	1907	1893	2194	1842	1551	2464	3254
Income Tax	978	949	1081	1047	972	(305)	1045	914	733	1149

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	26798	28328	27296	26232	27485	29924	30259	33518	35136	38068
Cash & Equivalents	156	201	45	110	131	56	195	49	446	657
Acc. Receivable	835	765	799	633	649	783	858	929	827	842
Inventories	231	257	289	256	269	337	409	468	457	462
Goodwill & Int.	57	55	53	51	50	49	54	175	169	164
Total Liabilities	15722	16163	15693	15459	16478	16678	17307	19707	19725	20230
Accounts Payable	388	383	400	282	359	587	721	663	612	708
Long-Term Debt	6936	7363	7212	7514	8112	8611	9228	10561	10121	9792
Total Equity	11075	12165	11603	10773	11008	13245	12952	13811	15411	17838
LTD/E Ratio	0.63	0.61	0.62	0.70	0.74	0.65	0.71	0.76	0.66	0.55

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	10.3%	9.2%	10.3%	10.4%	10.2%	14.7%	11.1%	10.0%	7.7%	10.7%
Return on Equity	24.9%	21.8%	24.1%	24.8%	25.2%	34.9%	25.5%	23.7%	18.2%	23.5%
ROIC	15.4%	13.5%	15.0%	14.9%	14.7%	20.7%	15.2%	13.6%	10.7%	14.7%
Shares Out.	857	831	809	787	762	743	735	717	711	701
Revenue/Share	11.34	12.14	13.35	12.27	11.67	13.29	14.98	15.55	14.47	16.26
FCF/Share	1.52	1.81	2.29	2.37	2.43	2.90	2.50	2.15	3.46	4.58

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.