



# Canadian National Railway (CNI)

Updated October 26<sup>th</sup>, 2022 by Nathan Parsh

## Key Metrics

<b>Current Price:</b>	\$121	<b>5 Year CAGR Estimate:</b>	6.2%	<b>Market Cap:</b>	\$81 B
<b>Fair Value Price:</b>	\$107	<b>5 Year Growth Estimate:</b>	7.0%	<b>Ex-Dividend Date:</b>	12/08/22
<b>% Fair Value:</b>	113%	<b>5 Year Valuation Multiple Estimate:</b>	-2.4%	<b>Dividend Payment Date:</b>	12/29/22
<b>Dividend Yield:</b>	1.9%	<b>5 Year Price Target</b>	\$150	<b>Years Of Dividend Growth:</b>	27
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	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 25<sup>th</sup>, 2022, Canadian National Railway increased its dividend 19.8% for the March 31<sup>st</sup>, 2022 payment date. On October 25<sup>th</sup>, 2022, Canadian National Railway announced third quarter results for the period ending September 30<sup>th</sup>, 2022. Revenue grew 14.3% to \$3.32 billion, beating estimates by \$147.1 million. Adjusted earnings-per-share of \$1.57 compared to \$1.23 in the prior year and was \$0.09 higher than expected.

Canadian National Railway's operating ratio improved 550 basis points to 57.2% year-over-year and was considerably better than the 66.6% and 59.3% figure that the company had in the first and second quarter of the year, respectively. Revenue ton miles (RTM) increased 5% to 58.5 billion. Grain and fertilizers revenue improved 22%, driven mostly by higher prices, though volume and RTMs were positive for the period. Intermodal revenue grew 26%, mostly due to higher realized prices. Petroleum and Chemical has revenue growth of 19%, as prices and RTMs were both up high single-digits. A 27% improvement in pricing drove a 19% gain in revenue for Metals and Minerals. Revenue for Forest Products were up 29% while coal improved 53%, mostly due to better price realization. Automotive surged 52% due to increases in volume and pricing.

Canadian National Railway now forecasts that adjusted earnings-per-share will grow by 25% for the year, up from a prior range of 15% to 20%. 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
<b>EPS</b>	\$2.84	\$2.88	\$3.23	\$3.20	\$3.44	\$3.82	\$4.31	\$4.41	\$4.00	\$4.75	<b>\$5.94</b>	<b>\$8.33</b>
<b>DPS</b>	\$0.76	\$0.81	\$0.86	\$0.90	\$1.12	\$1.25	\$1.39	\$1.62	\$1.64	\$1.96	<b>\$2.25</b>	<b>\$3.16</b>
<b>Shares<sup>1</sup></b>	857	831	809	787	762	743	735	717	711	701	<b>684</b>	<b>670</b>

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 \$5.94 allows us to compute a 2027 per-share-earnings estimate of \$8.33.

<sup>1</sup> Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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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	20.4	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%	2.1%

Shares of Canadian National Railway are essentially unchanged since our July 27<sup>th</sup>, 2022 report. The stock has traded at an average price-to-earnings ratio of 19.8 over the last decade, but is trading at slightly more than 20 times earnings estimates for the year. We are reaffirming our target price-to-earnings ratio of 18. If Canadian National Railway's price-to-earnings ratio contracts to this target then annual returns would be reduced by 2.4% over this period. We see the stock as overvalued today at 113% of fair value.

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

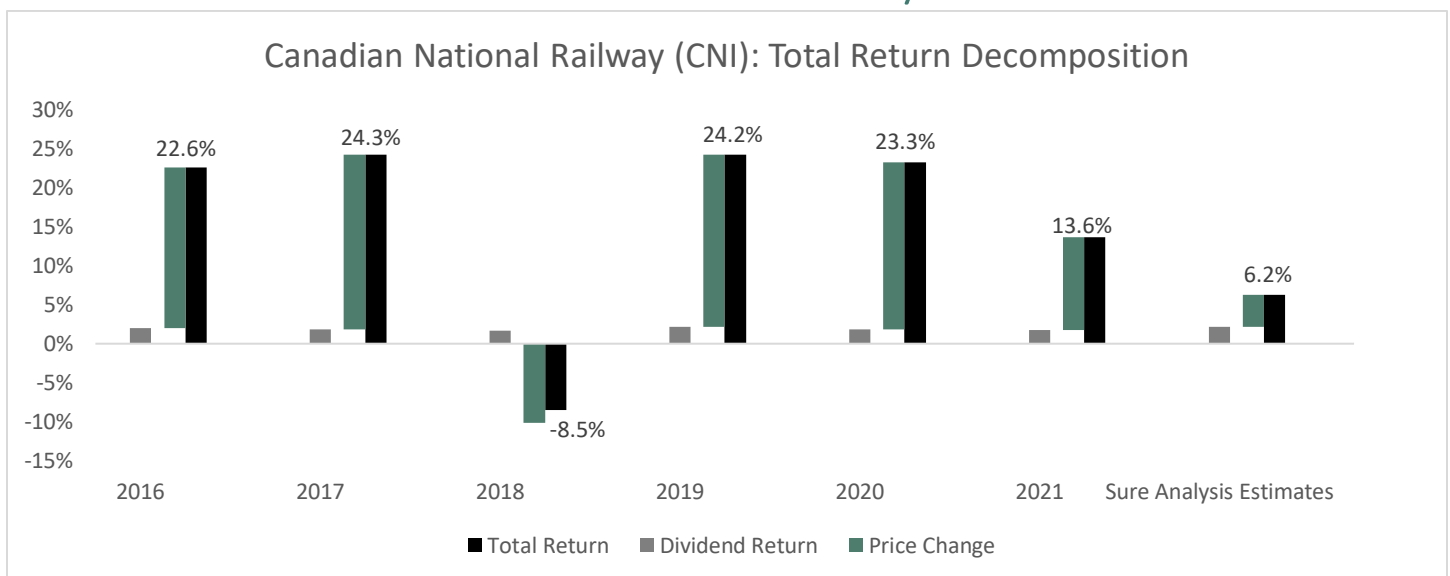
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	27%	28%	27%	28%	33%	33%	32%	37%	41%	41%	38%	38%

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 third quarter results, Canadian National Railway is now expected to offer a total annual return of 6.2% through 2027, up from our previous estimate of 5.1%. This projection stems from a 7% earnings growth rate and starting yield of 1.9%, offset by a low single-digit headwind from multiple contraction. Canadian National Railway experienced strong growth rates in nearly all of its product categories and the operating ratio showed remarkable improvement from the prior year. We have raised our 2027 price target \$9 to \$150, but maintain our hold rating on Canadian National Railway due to projected returns.

## Total Return Breakdown by Year



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## Income Statement Metrics

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

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	26798	28328	27296	26232	27485	29924	30259	33518	35136	38068
<b>Cash &amp; Equivalents</b>	156	201	45	110	131	56	195	49	446	657
<b>Acc. Receivable</b>	835	765	799	633	649	783	858	929	827	842
<b>Inventories</b>	231	257	289	256	269	337	409	468	457	462
<b>Goodwill &amp; Int.</b>	57	55	53	51	50	49	54	175	169	164
<b>Total Liabilities</b>	15722	16163	15693	15459	16478	16678	17307	19707	19725	20230
<b>Accounts Payable</b>	388	383	400	282	359	587	721	663	612	708
<b>Long-Term Debt</b>	6936	7363	7212	7514	8112	8611	9228	10561	10121	9792
<b>Total Equity</b>	11075	12165	11603	10773	11008	13245	12952	13811	15411	17838
<b>LTD/E Ratio</b>	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
<b>Return on Assets</b>	10.3%	9.2%	10.3%	10.4%	10.2%	14.7%	11.1%	10.0%	7.7%	10.7%
<b>Return on Equity</b>	24.9%	21.8%	24.1%	24.8%	25.2%	34.9%	25.5%	23.7%	18.2%	23.5%
<b>ROIC</b>	15.4%	13.5%	15.0%	14.9%	14.7%	20.7%	15.2%	13.6%	10.7%	14.7%
<b>Shares Out.</b>	857	831	809	787	762	743	735	717	711	701
<b>Revenue/Share</b>	11.34	12.14	13.35	12.27	11.67	13.29	14.98	15.55	14.47	16.26
<b>FCF/Share</b>	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.

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