Canadian National Railway

TSX: CNR   NYSE: CNI

Target Price: $138.80

Current Price: $156.72

Date 07/25/2023

Financial Analysis Report

SMIF Industrials: Nick Langley, Kirsten Vermette

Investment Thesis

Renowned for its operational efficiency and robust dividend growth, CNR stands as a beacon of stability in the industrials sector. As the most fuel-efficient Class 1 railway in North America, CNR demonstrates a commitment to sustainability and cost-effectiveness that sets it apart from its competitors. While CNR no longer holds the unique position of being the sole transcontinental railway, it compensates for this with remarkable profit margins that outshine its industry peers. Furthermore, the introduction of its Falcon Premium intermodal service has enabled CNR to effectively compete with CPKC in the realm of transcontinental services. In essence, an investment in CNR is not just a venture into the industrials sector, but a defensive strategy that capitalizes on the company's efficiency, profitability, and innovative service offerings. This combination of factors makes CNR a compelling investment proposition.

Company Overview

Description

Canadian National Railway is a leading transportation and logistics company. Services include rail, intermodal, trucking, and supply chain services. Its rail services offer equipment, customs brokerage services, transloading and distribution, private car storage and others. It transports more than 300 million tons of natural resources, manufactured products, and finished goods throughout North America every year. CN’s network of around 20,000 miles of track spans Canada and the United States of America (U.S.), connecting Canada’s Eastern and Western coasts with the Gulf of Mexico. CN is committed to programs supporting social responsibility and environmental stewardship.

Networks

CN Network

CN Intermodal Terminal

CN Automotive

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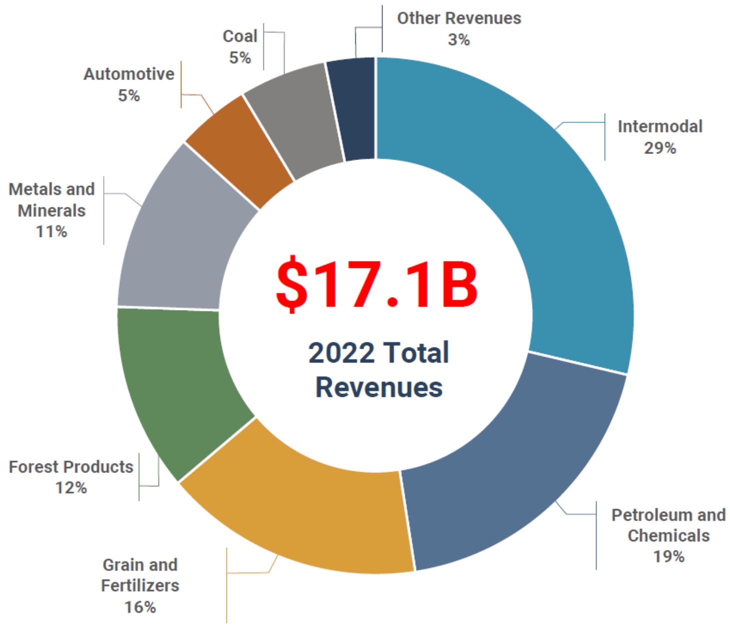
Business Segments

Freight revenue comprises 97% of the business, while the remaining 3% includes non-rail logistics services that support the company's rail business including vessels and docks, transloading and distribution, automotive logistics, and freight forwarding and transportation management. 2022 Revenue per geographic area is comprised of 68% from Canada and 32% from the United States.



Domestic and International Intermodal (29%): includes rail and trucking services. Domestic intermodal transports consumer products and manufactured goods within Canada, the U.S., and Mexico. International intermodal handles import and export container traffic through major ports. CN's network of intermodal terminals connects customers to key markets in NA and overseas. Domestic intermodal growth depends on consumer markets, while international intermodal is influenced by North American and global economic and trade conditions. Revenues from CN-owned TransX and H&R businesses are part of this commodity group in the domestic market.

Petroleum and chemicals (19%): primary market for these commodities is within NA, so its performance is strongly tied to its economy and oil/gas production. The majority of the company's shipments of petroleum and chemicals come from Western Canada, eastern Canadian regional plants, and the Louisiana petrochemical corridor (New Orleans to Baton Rouge).

Grain and Fertilizers (16%): segment relies mainly on crops and fertilizers from Western Canada and the U.S. Midwest. Grain production varies yearly due to weather conditions, acreage, and crop yields. Grain exports are influenced by crop size, quality, international markets, and foreign policies. Most Canadian grain moved by CN is exported via Vancouver, Prince Rupert, and Thunder Bay ports, subject to government-regulated revenue entitlements. Grain shipments to the U.S. are not regulated. In addition to grain, the company serves Canadian potash producers and fertilizers producers across Canada and the U.S. Fertilizer drivers include input prices, demand, government policies, and international competition.

Forest Products (12%): includes different types of lumber, panels, paper, board, wrapping paper, wood pulp, and other fibers like logs, recycled paper, wood chips, and wood pellets. The company has extensive rail access to major Canadian fiber-producing regions in the west and east. In the U.S., the company is strategically positioned to serve the Midwest and southern corridors and has interline connections with other major railroads. The key drivers for these commodities are housing starts and renovation activities primarily in the U.S., offshore markets for fibers, advertising lineage, non-print media, and overall economic conditions primarily in the U.S. for newsprint.

Metals and Minerals (11%): includes materials used in oil and gas development (like frac sand, drilling pipe, and large diameter pipe), as well as steel, iron ore, non-ferrous base metals and ores, raw materials like scrap metal, and industrial materials such as aggregates. The company has unique rail access to important mining and production regions for these commodities in NA, along with access to port facilities and end markets. The key drivers for this market segment are oil and gas development, automotive production, and non-residential construction.

Automotive (5%): includes transported finished vehicles and parts across NA, serving vehicle assembly plants in Ontario, Michigan, and Mississippi. The company also serves vehicle distribution and parts production facilities in Canada and the U.S. CN facilitates the distribution of finished vehicle imports through ports and interchanges with other railroads. Their wide network of auto compounds aids in vehicle distribution throughout Canada and the U.S. Midwest. Key drivers for this market are NA automotive production and sales, influenced by the average age of vehicles and fuel prices.

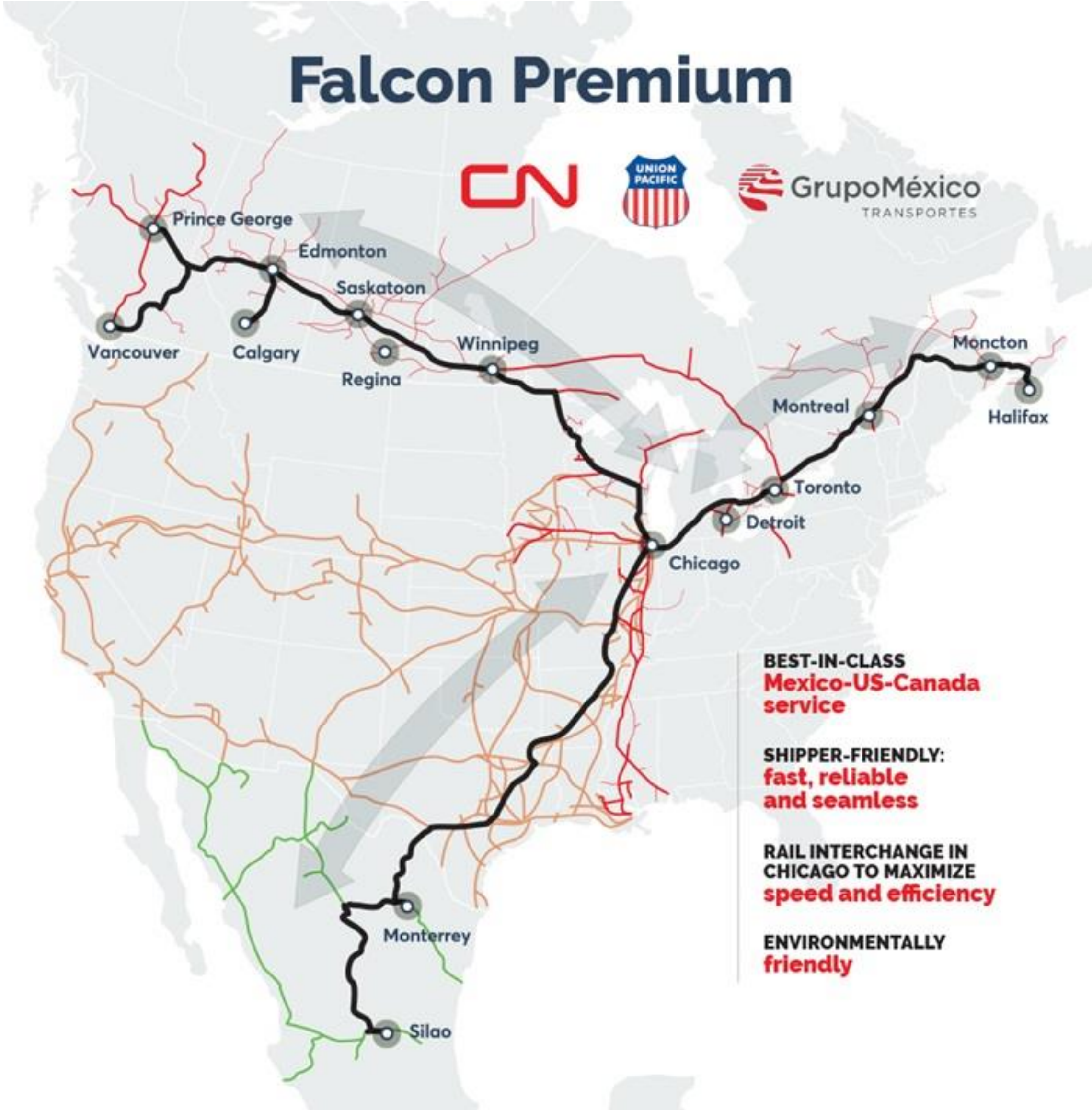
Coal (5%): includes thermal grades of bituminous coal, metallurgical coal, and petroleum coke. The commodity is mainly exported through west coast terminals to offshore markets. The key drivers for this market segment are weather conditions, environmental regulations, global energy, coal and steel supply and demand conditions, and for U.S. domestic utility coal, the price of natural gas.

Recent and Long-term Growth Projects

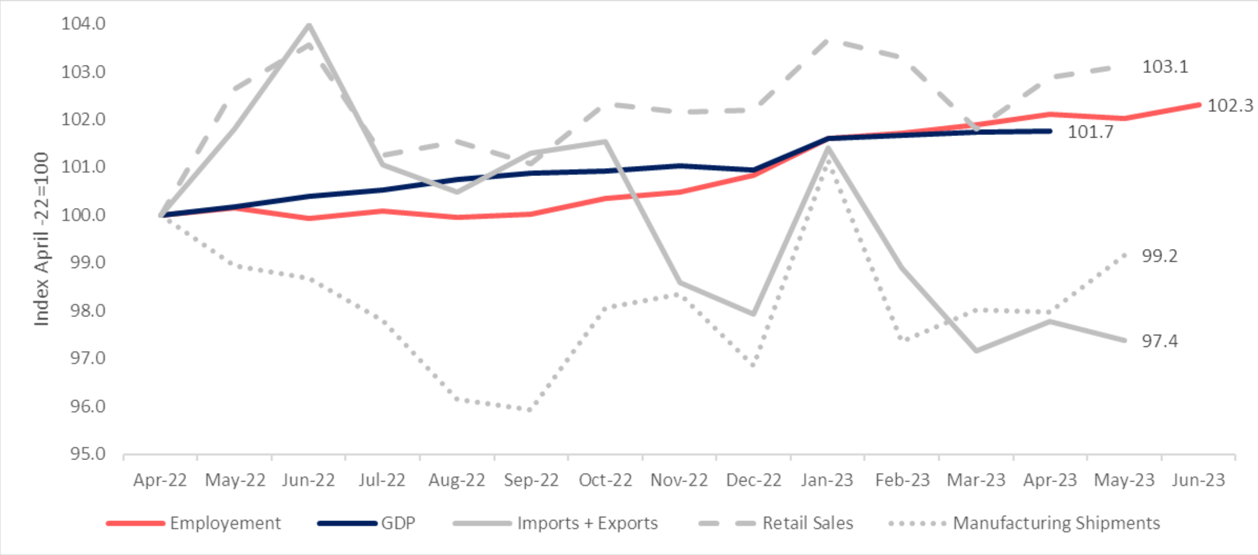
Carload and intermodal growth plans: CN believes it will add as many as 900,000 annual new carloads and intermodal containers to its system by 2026, which translates into 5% volume growth per year. CN expects growth to come from ports it serves in British Columbia, Atlantic Canada, and the Gulf Coast, as well as from multiple new projects on the northern tier of its system. CN is upgrading a portion of the Chetwynd and Fort St. John subdivisions, the former BC Rail line that runs north from Prince George to Fort Nelson, to handle the new traffic.

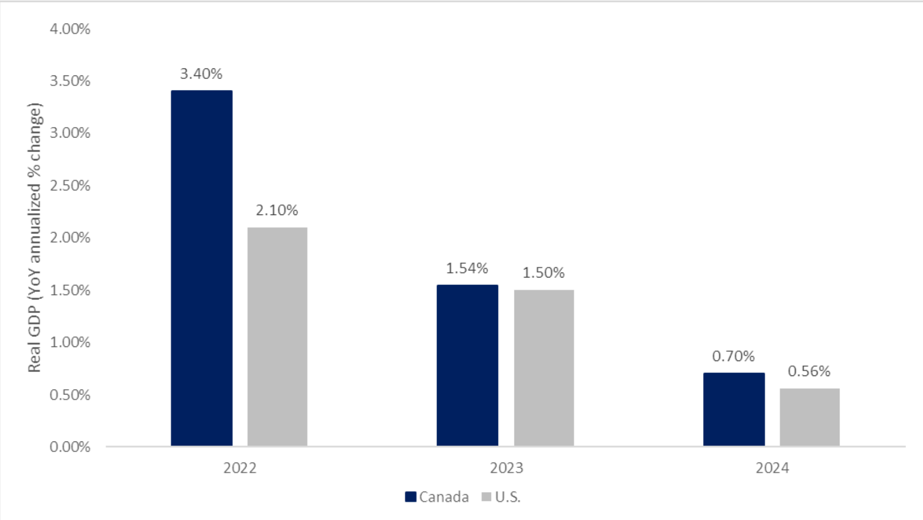
The Falcon Premium: Canada-US-Mexico Intermodal Service: partnership with Union Pacific (UP) and Ferromex (FXE), CN announced a new service offering between Canada, the U.S. Midwest, and Mexico. This seamless all-rail solution reduces the need for trucking producing less GHG emissions, while offering customers reliability and speed-to-market.

New fuel facility in Mac Yard: A fuel distribution center is under construction at CN's MacMillan Yard outside of Toronto that will handle up to 20,000 annual carloads of ethanol, renewable diesel fuel, and jet fuel. This is a result of the increase and transition to renewable energy, including biofuels. CN expects there will be an increase of 75,000 carloads over the next three years from soybeans and canola to processing plants.



Key Canadian Economic Indicators





Canadian and U.S. Real GDP Forecast

The 2023 outlook for rail varies by commodity. Headwinds include a forecasted contraction in North American industrial production and softening consumer demand, which may affect consumer-driven traffic, including intermodal; lumber; and energy, chemicals and plastics. 2023 expectations remain relatively stronger for bulk commodities, including grain (with an anticipated average crop for the 2022-2023 crop year), potash and coal. The figures represented in the Canadian and U.S. Real GDP forecast are the average of the five bank's latest forecasts.

Macro Indicators – Recent Trends

July 2023 data are not yet publicly available for all the key economic indicators. As such, April 2023 data are compared against February 2023 to analyze recent trends.

From February 2023 to April 2023, overall employment increased by 0.38% (76,100 jobs), from 20.05 million to 20.13 million. GDP increased by 0.08% from $2,083B to $2,085B. GDP increased in 9 out 20 sectors, including the transportation and warehousing sector, which grew by a modest 0.73%.

Trade (Exports + Imports) decreased by -1.15%. The most significant contributor to the reduction in trade was due to Metal ores and non-metallic mineral products and farm, fishing and intermediate food products. The decrease in these good more than offset the increase in Aircraft and other transportation equipment and parts. More recently, Q2 earnings have decreased due to softer than expected intermodal and forest product demand.

Domestic retail sales provide insight into household consumption, which is the largest contributor to Canada's GDP at over 50% of total GDP and a key driver of intermodal rail volumes. The increase for domestic retail sales from April to May was around 0.24%. However, over the past few months, intermodal rail volumes have been down, suggesting that retail sales may decline in the coming months.

Manufacturing shipments provide an indication into the strength of Canada's manufacturing sector and the global demand for its outputs. The increase from April to May was around 1.22%

Growth of Key Canadian Economic Indicators

	Employment (millions)	GDP($B, annualized)	Exports + Imports ($B)	Retail Sales ($B)	Manufacturing Shipments ($B)
February 2023	20.05	2,083	128.5	66.1	71.5
April 2023	20.13	2,085	127.0	65.9	72.0
3 - month change	**0.38%**	**0.08%**	**-1.15%**	**-0.40%**	**0.63%**

Operational Measures

Operational Measures	2022	2021	% Change
Statistical Operating Data			
RTM	463,710	458,401	1.16%
GTM	235,788	233,138	1.14%
FTM	5,697	5,701	-0.07%
Route Miles	18,600	19,500	-4.62%
Key Operating Measures			
Freight revenue per RTM (cents)	7.03	5.96	17.95%
Freight revenue per carload ($)	2,908	2,436	19.38%
GTMs per average number of employees (thousands)	19,820	19,033	4.13%
Operating expenses per GTM (cents)	2.21	1.93	14.51%
Average fuel price ($/US gallon)	402.20	405.20	-0.74%
Diesel fuel consumed (US gallons in millions)	5.42	3.28	65.24%
Fuel efficiency (US gallons of locomotive fuel consumed per 1,000 GTMs)	0.87	0.88	-1.92%
Car velocity (car miles per day)	196	195	0.51%
Safety Indicators			
Injury frequency rate (per 200,000 person hours)	1.10	1.36	-19.12%
Accident rate (per million train miles)	1.97	1.84	7.07%

From 2021-2022 CN increased its freight revenue per revenue ton miles (RTM) by 1.16%. More recently in the Q2 earnings report for 2023 CN has seen around an 8% decrease from it's three months ended June 30, 2022. This is a result of unprecedented Canadian wildfire and extreme heat that impacted the expected freight demand. CN believes there remains strong demand for bulk products in Canadian grain, potash, and metallurgical coal to offset some of the lost demand in other segments. In regard to diesel and fuel prices, CN will implement a fuel surcharge when invoicing its customers accordingly. CN is heavily invested in advancing a values-based safety culture and in aligning its ESG disclosures with global best practice frameworks. In 2022, CN announced that it joined the UN global compact initiative.

Stock Performance

Yellow – S&P/TSX Composite Index

- YTD: Increase of 5.70% from $19,443.77 on January 3rd to $20,551.53 on July 25th.
- 5Y: Increase of 32.77%

Blue – Canadian National Railway

- YTD: Decrease of -3.99% from $162.88 on January 3rd to $156.38 on July 25th.
- 5Y: Increase of 25.36%

YTD Stock Performance

5Y Stock Performance

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Comparable Company Analysis

(in millions $CAD)	Market Data		Financial Data			
	7/23/2023		3/31/2023			
Company	**Share Price**	**Market cap**	**S/O**	**EV**	**LTM EBITDA**	**NI**
Canadian National Railway Company (XTSE:CNR)	$ 156.71	$ 105,728	674.67	$ 122,904	$ 9,032	$ 1,220
Canadian Pacific Kansas City Limited (XTSE:CP)	$ 107.63	$ 100,210	931.06	$ 124,522	$ 6,106	$ 756
UNION PACIFIC CORPORATION (XNYS:UNP)	$ 286.63	$ 174,755	609.70	$ 221,087	$ 15,991	$ 2,203
CSX Corporation (XNAS:CSX)	$ 42.92	$ 86,109	2,006.33	$ 108,967	$ 9,965	$ 1,334
NORFOLK SOUTHERN CORPORATION (XNYS:NSC)	$ 308.09	$ 70,133	227.64	$ 90,106	$ 8,011	$ 1,026
USD/CAD	$ 1.32					

Relative Valuation

After applying the industry average PE and EBITDA multiple to CN's 2023E EPS and EBITDA, a share price of $139.92 and $134.86 was derived. Taking the average of the two we have a share price of $137.39. This share price implies that CN is currently trading at a 13.82% premium.

From observing the comparable analysis, we can see that CN has more growth potential than its competitors (other than CPKC). The ROE is slightly below its competitors, meanwhile its ROA is slightly above. The company's EBITDA margins are also above average, although it has a higher capex intensity. Another point worth mentioning is that the company has a lower D/E than its competitors at 0.84 vs. the industry average of 1.37.

2023E	Industry Average	CNR	Premium
P/E	18.26	0.00	11.76%
EV/EBITDA	12.22	0.20	15.95%

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($CAD)

Company	Operating Metrics: Revenue Growth	EBITDA Growth	FCF Growtth	EPS Growth
	(2022A - 2025E CAGR)			
CNR	3.87%	5.13%	3.89%	10.69%
CPKC	7.00%	11.48%	7.24%	10.00%
UNP	2.33%	3.10%	1.57%	6.05%
CSX	0.98%	1.07%	2.22%	4.35%
NSC	0.00%	1.82%	2.13%	3.99%
Average	**1.10%**	**2.00%**	**1.97%**	**4.79%**

($CAD)

Company	Operating Metrics: ROE		ROA		ROIC		EBITDA Margin	Capex Intensity
	2023E	2024E	2023E	2024E	2023E	2024E	(2022A - 2025E Average)	
CNR	24.39%	27.40%	10.48%	11.17%	15.14%	15.51%	52.09%	19.51%
CPKC	9.30%	10.27%	5.28%	6.21%	6.89%	10.00%	51.42%	17.56%
UNP	55.02%	58.60%	11.18%	11.68%	15.70%	16.50%	50.27%	14.60%
CSX	30.45%	32.03%	10.07%	10.47%	14.08%	14.77%	50.51%	13.02%
NSC	22.53%	24.12%	8.26%	8.55%	13.59%	13.91%	47.43%	13.55%
Average	**36.00%**	**38.25%**	**9.84%**	**10.23%**	**14.46%**	**15.06%**	**49.91%**	**13.73%**

($CAD)	Valuation Metrics									
	P/E		P/FCF		P/BV		EV/Revenue		EV/EBITDA	
	2023E	2024E	2023E	2024E	2023E	2024E	2023E	2024E	2023E	2024E
Company										
CNR	20.56	18.37	14.80	12.97	5.10	5.05	7.11	6.76	13.75	12.84
CPKC	27.26	22.88	20.75	16.76	2.44	2.27	9.23	8.12	17.86	15.26
UNP	19.28	17.71	13.97	13.03	10.58	10.50	6.27	6.41	13.41	12.62
CSX	17.53	16.26	12.47	11.19	5.56	5.38	5.70	5.58	11.41	11.01
NSC	17.99	16.54	11.77	11.42	4.07	3.96	5.47	5.31	11.83	11.13
Average	**18.26**	**16.84**	**12.73**	**11.88**	**4.02**	**3.87**	**5.81**	**5.77**	**12.22**	**11.59**

($CAD)	Capital Structure					
	D/E	Payout Ratio	Quick ratio	Net Debt / EBITDA	Dividen Yield	Dividend Growth
	2023 Q1			2023E EBITDA	2023E	(2022A - 2025E CAGR)
Company						
CNR	0.84	39.20%	0.66	1.92	2.01%	8.84%
CPKC	0.63	20.10%	0.50	3.33	0.70%	10.31%
UNP	2.73	45.20%	0.58	2.87	2.50%	4.03%
CSX	1.45	20.50%	1.42	2.37	1.33%	8.46%
NSC	1.20	35.70%	0.66	2.62	2.28%	5.23%
Average	**1.37**	**0.32**	**0.76**	**2.62**	**0.02**	**7.37%**

Discounted Cash Flow Analysis

Discount Rate (WACC)

Cost of debt is calculated using CNR's 2022 interest expense and total debt. The tax rate used is the average effective tax rate from 2017 to 2022. For capital structure calculations, net debt and total shareholder's equity is used. The beta used in the cost of equity calculation is the five-year monthly beta from Yahoo Finance. The S&P 500 10-year historical return is used as the market return and the Government of Canada five-year benchmark bond yield is used as the risk-free rate.

WACC Calculation	
WACC	5.92%
Cost of Debt	3.55%
Cost of Equity	8.17%
Tax Rate	22.96%
Debt as % of Capital Structure	41.39%
Equity as % of Capital Structure	58.61%
Beta	0.68
Risk Free Rate	3.32%
Market Return	10.45%

Assumptions

Revenue Growth: Historical average revenue growth from 2017-2021 was used as the revenue growth assumption in all five years of the model. 2022 was not including because it appeared to be an outlier with 18.17% growth.

EBITDA and EBIT Margins: The six-year historical average margins were calculated and used as a starting point in the five-year DCF model. Each subsequent year, EBITDA and EBIT margins grow by the six-year historical average margin growth.

Tax Rate: The six-year historical average effective tax rate was calculated using operating income and tax expense. This average historical tax rate increases each year in the model based on historical average changes in the tax rate.

Capital Expenditures: Average capital expenditures over the past six years was used as a starting point for the five-year DCF. Each year, capital expenditures is projected to grow by the historical average annual growth rate of 2.35%.

Long-Term Growth Rate: An adjusted average of Canadian and American real GDP growth was used as the long-term growth rate for CNR (1.9%). CNR's revenue can be split geographically with 68% from Canada and 32% from the U.S. and the adjusted average of Canadian and American GDP growth reflects that.

Terminal EBITDA Multiple: The average EV/EBITDA multiple for CNR peers (not including CNR) was used as the terminal EBITDA multiple (13.45x)

Assumptions						
	2017	2018	2019	2020	2021	2022
Revenue Growth		9.82%	4.16%	-7.36%	4.76%	18.17%
Adj Average	2.84%					
EBITDA Margin	50.03%	47.64%	47.97%	46.07%	49.83%	50.09%
Average	48.60%					
YOY Change		-4.78%	0.69%	-3.96%	8.17%	0.52%
Average YOY Change	0.13%					
EBIT Margin	40.20%	38.36%	37.49%	34.57%	38.79%	39.98%
Average	38.23%					
YOY Change		-4.60%	-2.25%	-7.80%	12.22%	3.07%
Average YOY Change	0.13%					
Capital Expenditures	-2673	-3531	-3865	-2863	-2891	-2750
Average	-3095.5					
% Change		32.10%	9.46%	-25.92%	0.98%	-4.88%
Average % Change	2.35%					
Tax Rate	-7.89%	23.82%	22.33%	21.59%	22.75%	24.32%
Average	22.96%					
% Change		31.71%	-1.49%	-0.74%	1.16%	1.57%
Average % Change	0.13%					

Discounted Cash Flow Valuation

Most recent fiscal year end	12-31-2022	Discount rate (WACC)	5.9%
End of first fiscal year	12-31-2023	Share price (Public Co)	$ 156.72
Most recent quarter end date	12-31-2022	Share price date	2023-07-25
Valuation date	07-25-2023	Midyear Adj. (1=MY, 0=EOY)	1
Portion of year 1 cash flows in forecase	43.3%		

Unlevered Free Cash Flows

		Actual	Forecasts				
Fiscal year ended		12-31-2022	12-31-2023	12-31-2024	12-31-2025	12-31-2026	12-31-2027
Revenue		17,107.0	17,594	18,094	18,609	19,138	19,682
% growth			2.8%	2.8%	2.8%	2.8%	2.8%
EBITDA		6,847	8,551	8,818	9,092	9,376	9,668
% margin		40.0%	48.6%	48.7%	48.9%	49.0%	49.1%
EBIT		5,118.0	6,727	6,941	7,163	7,391	7,627
% margin		29.9%	38.2%	38.4%	38.5%	38.6%	38.7%
Tax on EBIT		1,245	1,545	1,603	1,663	1,725	1,790
Tax rate		24.3%	23.0%	23.1%	23.2%	23.3%	23.5%
NOPAT (aka EBIAT)		**3,873**	**5,182**	**5,339**	**5,500**	**5,666**	**5,837**
Depreciation & amortization		1,729.0	1,824	1,876	1,930	1,985	2,041
Changes in net working capital		424	42	43	44	45	46
Capital expenditures		(2,750.0)	-3,096	-3,168	-3,242	-3,319	-3,396
as % of revenue		16.1%	17.6%	17.5%	17.4%	17.3%	17.3%
Unlevered fee cash flows (UFCF)		**3,276**	**3,952**	**4,089**	**4,231**	**4,377**	**4,528**
Net working capital (WC Assets - WC liabilities)	-1,035	-1,459	-1,501	-1,543	-1,587	-1,632	-1,679
as % of revenue		(8.5%)	(8.5%)	(8.5%)	(8.5%)	(8.5%)	(8.5%)

Present value of UFCF on Jul 25, 2023 valuation date

		Val Date	Yr 1 - Stub	Year 2	Year 3	Year 4	Year 5
Date for discounting cash flows		07-25-2023	07-01-2023	07-01-2024	07-01-2025	07-01-2026	07-01-2027
Unlevered free cash flows (UFCF) stub adjusted	43.3%		1,713	4,089	4,231	4,377	4,528
Present value of unlevered free cash flows			**1,719**	**3,876**	**3,785**	**3,697**	**3,611**

Terminal value - growth in perpetuity approach		**Terminal Value - EBITDA multiple approach**	
Long term growth rate	1.9%	Terminal year EBITDA	9,668
2027 FCF x (1+g)	4,614	EBITDA multiple	13.45x
Terminal value in 2027	114,776	Terminal value 2027	130,034
Present value of terminal value	91,526	Present value of terminal value	103,694
Present value of stage 1 cash flows	16,688	Present value of stage 1 cash flows	16,688
Total enterprise value (TEV)	**108,214**	**Enterprise value (stage 1 + 2)**	**120,382**
Terminal value as a % of TEV	*84.6%*	Terminal value as % of TEV	*86.1%*
Stage 1 cash flows as % of TEV	*15.4%*	Stage 1 cash flows as % of TEV	*13.9%*
Implied TV exit EBITDA multiple	*11.9x*	Implied terminal growth rate	*2.4%*

Net Debt

Source doc	2022 10K
Source date	12-31-2022
Gross debt and equivalents	
Debt	15,429
Convertible debt	0
Preferred Stock	0
Noncontrolling (minority) interests	0
Nonoperating assets	
Cash	328
Equity investments	34
Net debt	15,067

Shares outstanding

	Source doc	Date	Shares
Basic shares			671.000
Resricted stock / RSUs			
Options / warrants			
Convertible debt			
Convertible preferred stock			
Net diluted shares outstanding (Millions)			671

Valuation

	Perpetuity	EBITDA	Average
Enterprise value	108,214	120,382	114,298
Net debt	15,067	15,067	15,067
Equity value	93,147	105,315	99,231
Shares outstanding (MM)	671	671	671
Equity value per share (price target)	**$ 138.82**	**$ 156.95**	**$ 147.89**

Year 1 Multiples	Perpetuity	EBITDA
EV / Revenue	6.2x	6.8x
EV / EBITDA	12.7x	14.1x
EV / EBIT	16.1x	17.9x

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Sensitivity Analysis

Equity value per share

	$ 138.82	Long term growth rate (g): 0.9%	1.4%	1.9%	2.4%	2.9%
	7.9%	73.30	68.19	68.19	73.30	86.06
	6.9%	88.84	81.77	81.77	88.84	107.19
WACC:	5.9%	110.57	100.29	**100.29**	110.57	138.82
	4.9%	143.13	127.01	127.01	143.13	191.41
	3.9%	197.26	168.91	168.91	197.26	296.07

Year 1 EBITDA multiple

	12.7x	Long term growth rate (g): 0.9%	1.4%	1.9%	2.4%	2.9%
	7.9%	7.5x	7.1x	7.1x	7.5x	8.5x
	6.9%	8.7x	8.2x	8.2x	8.7x	10.2x
WACC:	5.9%	10.4x	9.6x	**9.6x**	10.4x	12.7x
	4.9%	13.x	11.7x	11.7x	13.x	16.8x
	3.9%	17.2x	15.x	15.x	17.2x	25.x

Equity value per share

	$ 156.95	Exit EBITDA Multiple: 12.5x	13.x	13.45x	14.x	14.5x
	7.9%	134.34	129.00	129.00	134.34	145.01
	6.9%	139.77	134.24	134.24	139.77	150.85
WACC:	5.9%	145.46	139.72	**139.72**	145.46	156.95
	4.9%	151.42	145.45	145.45	151.42	163.34
	3.9%	157.66	151.46	151.46	157.66	170.04

Year 1 EBITDA multiple

	14.1x	Exit EBITDA Multiple: 12.5x	13.x	13.45x	14.x	14.5x
	7.9%	12.3x	11.9x	11.9x	12.3x	13.1x
	6.9%	12.7x	12.3x	12.3x	12.7x	13.6x
WACC:	5.9%	13.2x	12.7x	**12.7x**	13.2x	14.1x
	4.9%	13.6x	13.2x	13.2x	13.6x	14.6x
	3.9%	14.1x	13.6x	13.6x	14.1x	15.1x

DCF Summary

CNR appears to be overvalued by according to our model by 11.4%. Although the thesis for CN is strong, it appears now is not the right time to make it an addition to our portfolio.

Enterprise Value		
Cumulative Present Value of FCF	**$**	**16,677**
Growth in Terminal Year		1.9%
Terminal Value	**$**	**114,776**
PV of Terminal Value	$	91,526
Total Value	**$**	**108,203**
Terminal Value % of Total		**84.6%**
Implied Terminal Multiple		11.9x
Implied Equity Value and Share Price		
Enterprise Value	$	108,203
Less: Net Debt (Ex Operating Leases)	**$**	**15,067**
Implied Equity Value	**$**	**93,136.48**
Fully Diluted Shares Outstanding (M)		671.000
Implied Share Price	**$**	**138.80**
Current Share Price (USD)	$	156.72
Dividend	$	3.16
Return on Target		**-11.4%**

SWOT Analysis

Strengths

- Operational Efficiency and Margins: CNR is renowned for its operational efficiency, consistently achieving one of the industry's best operating ratios. This efficiency is a testament to CNR's effective management and its ability to control costs while maintaining high service levels. Furthermore, CNR's impressive margins relative to its peers underscore its strong financial management and profitability
- Extensive Network: CNR operates the longest railway network in North America, spanning over 31,000 kilometers. This extensive network, reaching from the Atlantic coast in Nova Scotia to the Pacific coast in British Columbia, allows CNR to serve a broad customer base and access a wide range of markets. This geographical reach provides CNR with a significant competitive advantage, enabling it to offer comprehensive and efficient transportation solutions to its customers. The extensive network also enhances CNR's ability to handle diverse cargo types and volumes, contributing to its revenue diversification and resilience.
- Dividend Growth and High Payout Ratio: CNR has a strong track record of dividend growth, demonstrating its commitment to returning capital to shareholders. This consistent growth in dividends is a testament to CNR's robust financial health and its confidence in its future earnings potential. Additionally, CNR's high payout ratio further underscores its dedication to shareholders.

Weaknesses

- Safety Record: CNR's safety record has been a point of concern. The company has faced high levels of safety related incidents in the past, which not only impact its operational efficiency but also pose potential reputational risks pertaining to the safety of workers and goods. These incidents underline the need for CNR to invest more in safety measures and protocols. A failure to improve its safety record could lead to regulatory scrutiny, potential fines, and a loss of customer trust, all of which could negatively impact its market position and financial performance.

Opportunities

- Falcon Premium Intermodal Service: CNR's strategic partnership with Union Pacific (UP) and Ferromex (FXE) has led to the launch of a new service offering that connects Canada, the U.S. Midwest, and Mexico. This all-rail solution not only minimizes the reliance on trucking, thereby reducing greenhouse gas emissions, but also offers customers enhanced reliability and speed-to-market. This initiative presents a significant opportunity for CNR to expand its market reach.

Threats

- CPKC's Single-Line Transcontinental Railway: CPKC's operation of a single-line transcontinental railway poses a significant threat to CNR. This streamlined network offers a direct, efficient route across the continent, potentially attracting customers seeking faster and more reliable services. The competitive edge provided by this single-line system could challenge CNR's market share and influence in the transcontinental rail services sector. Furthermore, CPKC’s strategic partnerships with Schneider and Knight-Swift are designed to take market share from CN.

Conclusion

In conclusion, while Canadian National Railway (CNR) presents a compelling case with its operational efficiency, robust dividend growth, and extensive network coverage, our analysis suggests that it may not be the right time to invest in the company. Despite the company's strengths, such as its impressive margins, innovative service offerings, and commitment to sustainability, the current overvaluation of the stock presents a significant concern. CNR's strategic initiatives, such as the Falcon Premium intermodal service, demonstrate its ability to adapt and compete in the evolving rail industry. However, the company also faces challenges, including its safety record and the competitive threat posed by CPKC's single-line transcontinental railway. The company's financial performance, coupled with its high payout ratio, underscores its commitment to returning capital to shareholders. However, the current share price suggests that the stock is trading at a premium, which could limit the potential for capital appreciation. Given the current valuation, we recommend not investing in CNR at this moment. We believe that while CNR has a strong business model and strategic advantages, the current stock price does not offer an attractive entry point for investors. We will continue to monitor CNR and the broader rail industry for potential investment opportunities in the future.