

Canadian National

Targets ~10% EPS growth, led by mid-single digit vol growth (2H ramp); PO \$131

Reiterate Rating: NEUTRAL | PO: 131.00 USD | Price: 125.79 USD

Targets '24 EPS growth in line with Street; sees 2H ramp

Canadian National posted 4Q23 adjusted EPS of C\$2.02, down 4% year-year, above our C\$1.93 target/Street's C\$1.99. For 2024, CN targets EPS growth of about 10% (we're now +10%, were +13%), the low-end of its 10-15% 2024-2026 long term target range. It assumes slightly positive industrial production, a below average Canadian grain crop in '23-'24 returns to an average crop in '24-'25, and sees C\$200 million in cost headwinds (C\$100m from higher Depreciation, as well as higher incentive comp and pension costs). It targets mid-single digit revenue ton mile (RTM) growth, as volumes ramp throughout '24, as it laps challenging 1Q23 comps and harsher winter weather in 1Q24, with 2H upside led by customer growth initiatives. Embedded within its target, CEO Tracy Robinson expects slight operating ratio improvement. We target 90 bps improvement, to 59.9%, led by strides in service and operating leverage, as it builds trains at lower incremental cost. CN expects normal operating ratio seasonality in 2024 after an abnormally better 1Q23, on light winter weather (typically worst Q) and a weak 3Q23 (normally best) given the port strike. Chief Network Officer Patrick Whitehead noted that origin train performance was 90%, yet sees room to improve destination train performance from 70%, as it reduces delays and improves crew change efficiency. It sees international intermodal volume upside (to West Coast) from Red Sea diversions.

Core ops top targets, aided by strong yields

CN posted 4Q23 revenues of C\$4.5 billion, down 2% year-year, but C\$224 million above our target. Operating income was C\$1.8 billion, down 5% year-year, but C\$93 million above our target (\$0.11/sh above), for an adjusted operating ratio of 59.3%, a 140 bps deterioration year-year, but 10 bps better than our target.

PO \$131; stock to see minor relief offset by ramp outlook

We could see CNI's shares benefit from a minor relief rally following tonight's results as EPS beat targets and it set a double-digit EPS growth outlook, generally in-line with the Street outlook. However, the upside should be contained given the need for a significant volume and leverage performance which is back end weighted given the soft Canadian grain crop. We remain Neutral but bump our PO to US\$131 (from US\$128) on 22x (from 21x) our 2024e EPS. We are below the top of its 5-year 18x-23x range as earnings return to growth phase. We lower our 2024/2025 EPS estimates 2%/1%, to C\$8.00/C\$9.00, from C\$8.20/C\$9.05, respectively. We launch 2026e at C\$9.90.

Estimates (Dec) (C\$)	2022A	2023A	2024E	2025E	2026E
EPS	7.50	7.28	8.00	9.00	9.90
GAAP EPS	7.44	8.54	8.00	9.00	9.90
EPS Change (YoY)	26.3%	-2.9%	9.9%	12.5%	10.0%
DPS	2.93	3.16	3.38	3.64	3.88
Valuation (Dec)					
P/E	22.7x	22.8x	21.2x	18.8x	17.1x
GAAP P/E	22.9x	19.4x	21.2x	18.8x	17.1x
Dividend Yield	1.7%	1.9%	2.0%	2.1%	2.3%
EV / EBITDA*	15.4x	15.8x	14.6x	13.4x	12.5x
Free Cash Flow Yield*	3.6%	3.4%	3.6%	4.0%	4.2%

* For full definitions of *IQmethod*SM measures, see page 7.

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Timestamp: 23 January 2024 10:51PM EST

23 January 2024

Equity

Key Changes

(C\$)	Previous	Current
Price Obj.	US\$128.00	US\$131.00
2024E Rev (m)	17,362.5	17,917.6
2025E Rev (m)	18,390.6	19,158.5
2026E Rev (m)	NA	20,303.7
2024E EPS	8.20	8.00
2025E EPS	9.05	9.00
2026E EPS	NA	9.90
2024E DPS	3.40	3.38

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Stock Data

Price	125.79 USD
Price Objective	131.00 USD
Date Established	23-Jan-2024
Investment Opinion	B-2-7
52-Week Range	103.96 USD - 127.15 USD
Mrkt Val (mn) / Shares Out (mn)	82,468 USD / 655.6
Free Float	96.8%
Average Daily Value (mn)	116.66 USD
BofA Ticker / Exchange	CNI / NYS
Bloomberg / Reuters	CNI US / CNI.N
ROE (2024E)	23.2%
Net Dbt to Eqty (Dec-2023A)	87.2%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

iQprofileSM Canadian National

iQmethodSM – Bus Performance*

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	11.1%	10.2%	10.1%	9.9%	9.5%
Return on Equity	23.4%	23.1%	23.2%	21.5%	19.6%
Operating Margin	40.3%	39.2%	40.1%	41.3%	42.0%
Free Cash Flow	3,917	3,778	3,970	4,444	4,694

iQmethodSM – Quality of Earnings*

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.3x	1.5x	1.5x	1.5x	1.5x
Asset Replacement Ratio	1.6x	1.8x	1.8x	1.8x	1.9x
Tax Rate	24.3%	24.5%	25.0%	25.0%	25.0%
Net Debt-to-Equity Ratio	68.3%	87.2%	86.6%	82.4%	77.9%
Interest Cover	12.6x	9.1x	8.3x	7.9x	7.4x

Income Statement Data (Dec)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	17,107	16,828	17,918	19,159	20,304
% Change	18.2%	-1.6%	6.5%	6.9%	6.0%
Gross Profit	8,626	8,414	9,100	9,922	10,607
% Change	19.5%	-2.5%	8.1%	9.0%	6.9%
EBITDA	8,626	8,414	9,100	9,922	10,607
% Change	19.5%	-2.5%	8.1%	9.0%	6.9%
Net Interest & Other Income	(77)	(238)	(421)	(564)	(714)
Net Income (Adjusted)	5,161	4,800	5,072	5,514	5,855
% Change	22.4%	-7.0%	5.7%	8.7%	6.2%

Free Cash Flow Data (Dec)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	5,118	5,625	5,072	5,514	5,855
Depreciation & Amortization	1,729	1,817	1,915	2,006	2,086
Change in Working Capital	NA	NA	NA	NA	NA
Deferred Taxation Charge	404	(288)	507	551	586
Other Adjustments, Net	(584)	(189)	(24)	74	82
Capital Expenditure	(2,750)	(3,187)	(3,500)	(3,701)	(3,914)
Free Cash Flow	3,917	3,778	3,970	4,444	4,694
% Change	-4.0%	-3.5%	5.1%	11.9%	5.6%
Share / Issue Repurchase	(4,803)	(4,535)	(4,400)	(4,550)	(4,550)
Cost of Dividends Paid	(2,004)	(2,071)	(2,139)	(2,226)	(2,291)
Change in Debt	2,140	3,200	2,725	2,500	2,500

Balance Sheet Data (Dec)

(C\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	834	924	690	857	1,210
Trade Receivables	1,371	1,300	1,539	1,622	1,713
Other Current Assets	1,012	865	882	900	920
Property, Plant & Equipment	43,537	44,617	46,202	47,897	49,725
Other Non-Current Assets	3,908	4,960	10,307	15,476	20,654
Total Assets	50,662	52,666	59,619	66,752	74,223
Short-Term Debt	1,057	2,340	2,340	2,340	2,340
Other Current Liabilities	2,785	2,695	2,910	3,066	3,239
Long-Term Debt	14,372	16,133	18,858	21,358	23,858
Other Non-Current Liabilities	10,723	11,083	11,590	12,142	12,727
Total Liabilities	29,278	32,549	35,930	39,049	42,164
Total Equity	21,384	20,117	23,689	27,703	32,058
Total Equity & Liabilities	50,662	52,666	59,619	66,752	74,223

* For full definitions of iQmethodSM measures, see page 7.

Company Sector

Rail Transport/Railroads

Company Description

Canadian National (CNI) is a nationwide railroad in Canada with a network that stretches from Halifax on the east coast of Canada to Vancouver and Prince Rupert on the west coast of Canada and south into New Orleans in the US. It generates 23% of revenues domestically, 57% of revenues within the US or trans-border and 20% from International traffic.

Investment Rationale

Canada National looks to post sustained volume growth given its network, and aims to continue to price above inflation. It has traded at or above the top end of its 13.5x-20x historical range over the past few years (21x past 3-year average, 20x past 5-yr average). We maintain a balanced view on shares, with potential catalysts being an acceleration of its execution on cost cutting and improved free cash flow story.

Stock Data

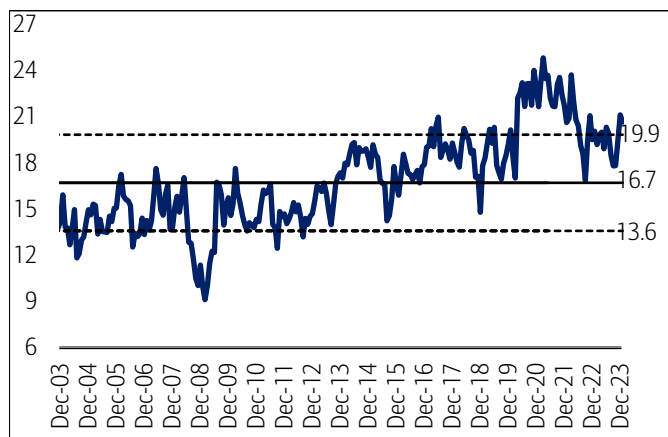
Average Daily Volume 927,413

Quarterly Earnings Estimates

	2023	2024
Q1	1.82A	1.60E
Q2	1.76A	1.96E
Q3	1.69A	2.11E
Q4	2.02A	2.34E

Exhibit 1: CNI Forward P/E

Shares are trading at 21x our 2024 EPS estimate, above its 14x-20x 20-year range (just above the mid-point of its 18x-23x five-year range).

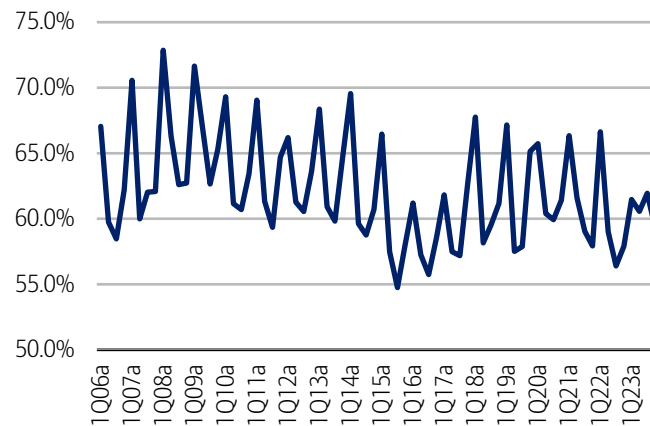


Source: BofA Global Research estimates and Bloomberg.

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Exhibit 2: CNI Operating Ratio

Operating ratio was 59.3% in 4Q23, 10 bps better than our target.



Source: BofA Global Research and company reports.

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Volumes beat aided by acceleration into yearend

Carloads were down 1.4% year-year in 4Q23, better than our -3.8% target. Volumes for Petroleum & Chemicals (+8% vs our +5% target), Metals & Minerals (+2% vs our -1% target), Forest Products (-6% vs our -8% target), Intermodal (-6% vs our -10% target), and Coal (-1% vs our -2% target) all came in stronger than our targets. However, Automotive (+13% vs our +16% target) and Grain & Fertilizer (-3% vs our flat target) volumes were below our targets.

Canadian National highlighted 4Q23 Canadian grain demand was the lowest it has seen in years as farmers held onto inventories after a correction in global pricing. It anticipates volumes to be pushed out into 1H24 as it sees volumes as deferred as opposed to lost. It also noted that Intermodal volumes at Vancouver and Prince Rupert has recovered back to pre-labor strike levels. In 2024, the company views growth as challenged in 1H24 (we target average 1H24 carload growth of +1.6%) due to challenging comps, yet target 2H volumes to accelerate (we expect average 2H carload growth of +7.7%) aided by business wins. It anticipates the completion of its Iowa Northern Railway acquisition by Fall 2024 to lead to increased US Grain volumes in 2H24 (a C\$312 million acquisition).

Yields supported by continued pricing over inflation

Average revenue/carload was down 0.8% year-year, better than our -3.6% target as all carload groups reported yields above or in line with our target. The company expects pricing over rail inflation to be driven by its service gains, and yet partly offset by lower fuel surcharges. It expects Intermodal yield growth pressure in 1Q24 as it laps \$100 million in container storage fees it benefited from last year (surcharges that disappeared as network fluidity returned). It believes yield pressures will not persist in 2Q24 and onwards. We expect it to sustain core pricing gains as it improves service. We target average revenue/carload to increase 1.8% (from +0.7% year-year previously) in 2024.

Service continues to improve yet weather may impact 1Q

Freight car velocity was 215 car miles/day and average through dwell was 6.9 hours in 4Q23. Both metrics improved 4% year-year despite a lower mix of Intermodal traffic which are typically more time sensitive. EVP Derek Taylor highlighted that the network fluidity benefited from an unseasonably warm 4Q and as it converts 900 new Train, Engine & Yard headcounts to offset attrition. The company expects to increase hiring with the return of volume growth.

However, the company noted that service has been impacted by a cold snap in early 1Q24, as temperatures declined to -40 to -50 Celsius for a week. It aims to close the

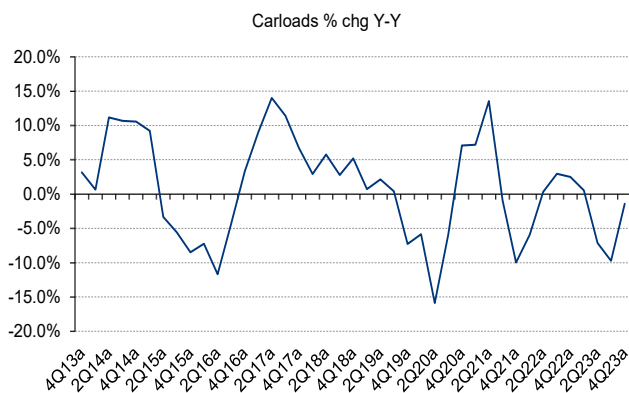
gap between its origin performance (~90%) and destination performance (~70%) through improved crew changes and lowering dwell time.

Slows buyback, bumps dividend, and set to close acqs

CN targets C\$3.5 billion in capex in 2024, up from C\$3.2 billion in 2023, rising to 19.5% of our revenue target from 19.0% in 2023. It increased its dividend 7%, to C\$0.845, in line with our C\$0.85 target, which represents a 42% payout ratio. Additionally, it slowed its buyback to C\$4 billion (32 million share NCIB – normal course issuer bid, which represents 5.6% of its current outstanding shares between Feb 1, 2024 and Jan 31, 2025). This is below our prior C\$4.5 billion target, given its planned C\$312 million purchase of Iowa Northern Railway, a Class III railroad in Northeast Iowa, with approximately 175 route miles (expected to close Fall 2024) and its planned C\$78 million acquisition of Central Nova Scotia Railway, a Class III railroad from Genesee & Wyoming, a short-line that owns 150 route miles. CFO Ghislaine Houle reiterated the company's target of 2.5x (max) debt/EBITDA, building from the current 2.25x over the next few years (2024-2026).

Exhibit 3: CN Carloads Year-Year Growth

Carloads were down 1.4% year-year in 4Q23, better than our -3.8% target.

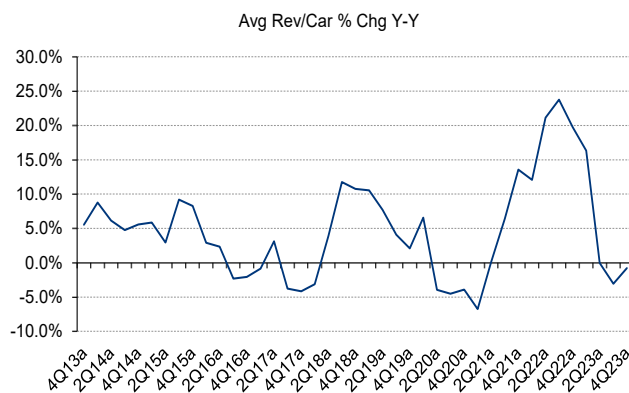


Source: BofA Global Research and company reports.

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Exhibit 4: CN Average Revenue/Carload Year-Year Growth

Avg revenue/carload was down 0.8% y-y in 4Q, better than our -3.6% target.

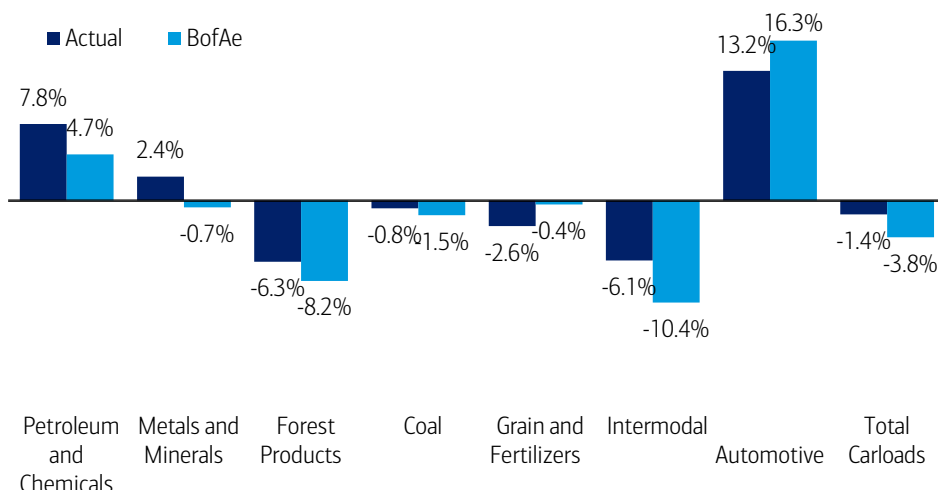


Source: BofA Global Research and company reports.

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Exhibit 5: CNI 4Q23 Carload Growth

Carloads were down 1.4% year-year in 4Q23, better than our -3.8% target.

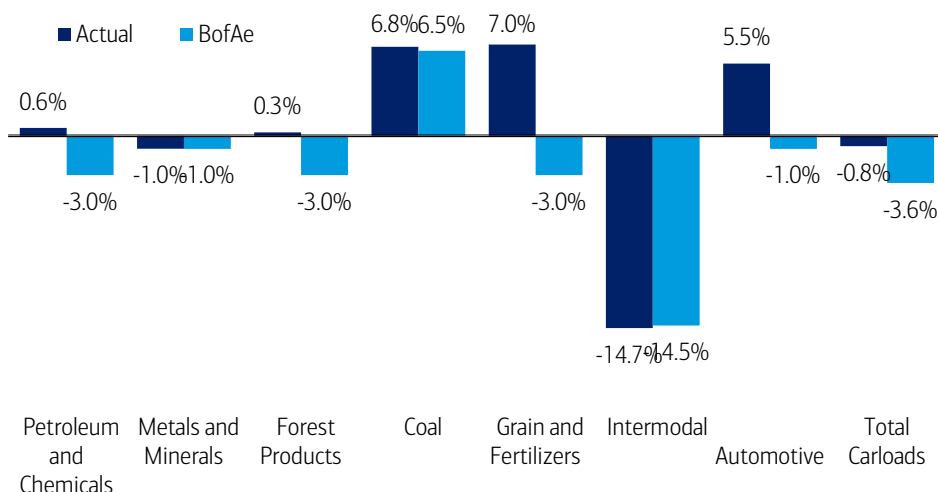


Source: BofA Global Research and company reports.

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Exhibit 6: CNI 4Q23 Yield Growth

Average revenue per carload was down 0.8% year-year, better than our -3.6% target.



Source: BofA Global Research and company reports.

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Price objective basis & risk

Canadian National (CNI)

Our US\$131 price objective is based on a 22x multiple on our 2024 US\$ EPS estimate, above the midpoint its 5-year 18x-23x one standard deviation trading range (above the top of its 13.5x-20x 20-year historical trading range), a premium to peer average given its service yet near market value of shares.

Downside risks to our price objective and estimates are slower-than-expected economic growth, higher-than-historical-average costs (including fuel) and those costs outpacing surcharges, potential disruptions from a highly unionized (79%) labor force, volume or pricing softness, regulatory changes, a surge in the Canadian dollar relative to the U.S. dollar, and external factors (such as weather) impacting operations. Disruptive rail re-regulation that limits the company's ability to earn proper returns on its investments would also be a downside risk. Additionally, CP continues to improve ops which could cause an increase in price competition.

Upside risk to our price objective would be stronger than expected acceleration in carload volumes, a larger than expected Canadian grain harvest season, an uptick in macro demand, and greater than anticipated cost reductions through CN's service gains.

Analyst Certification

I, Ken Hoexter, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Transportation Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Canadian Pacific Kansas City Ltd	CP	CP US	Ken Hoexter
	CSX Corporation	CSX	CSX US	Ken Hoexter
	FedEx Corp.	FDX	FDX US	Ken Hoexter
	J.B. Hunt Transport Services	JBHT	JBHT US	Ken Hoexter
	Kirby Corp	KEX	KEX US	Ken Hoexter
	Knight-Swift Transportation Holdings Inc	KNX	KNX US	Ken Hoexter
	Norfolk Southern	NSC	NSC US	Ken Hoexter
	Old Dominion Freight Line	ODFL	ODFL US	Ken Hoexter
	RXO, Inc.	RXO	RXO US	Ken Hoexter
	Saia Inc.	SAIA	SAIA US	Ken Hoexter
	Teekay Tankers Limited	TNK	TNK US	Ken Hoexter
	Union Pacific	UNP	UNP US	Ken Hoexter
	Wabtec Corp.	WAB	WAB US	Ken Hoexter
	XPO, Inc.	XPO	XPO US	Ken Hoexter
NEUTRAL				
	Canadian National	CNI	CNI US	Ken Hoexter
	Schneider National	SNDR	SNDR US	Ken Hoexter
	Scorpio Tankers Inc.	STNG	STNG US	Ken Hoexter
	TFI International	TFII	TFII US	Ken Hoexter
	TFI International	YTFII	TFII CN	Ken Hoexter
	UPS	UPS	UPS US	Ken Hoexter
UNDERPERFORM				
	ArcBest Corporation	ARCB	ARCB US	Ken Hoexter
	C.H. Robinson	CHRW	CHRW US	Ken Hoexter
	The Greenbrier Companies	GBX	GBX US	Ken Hoexter
	Werner Enterprises	WERN	WERN US	Ken Hoexter
	World Kinect	WKC	WKC US	Ken Hoexter

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

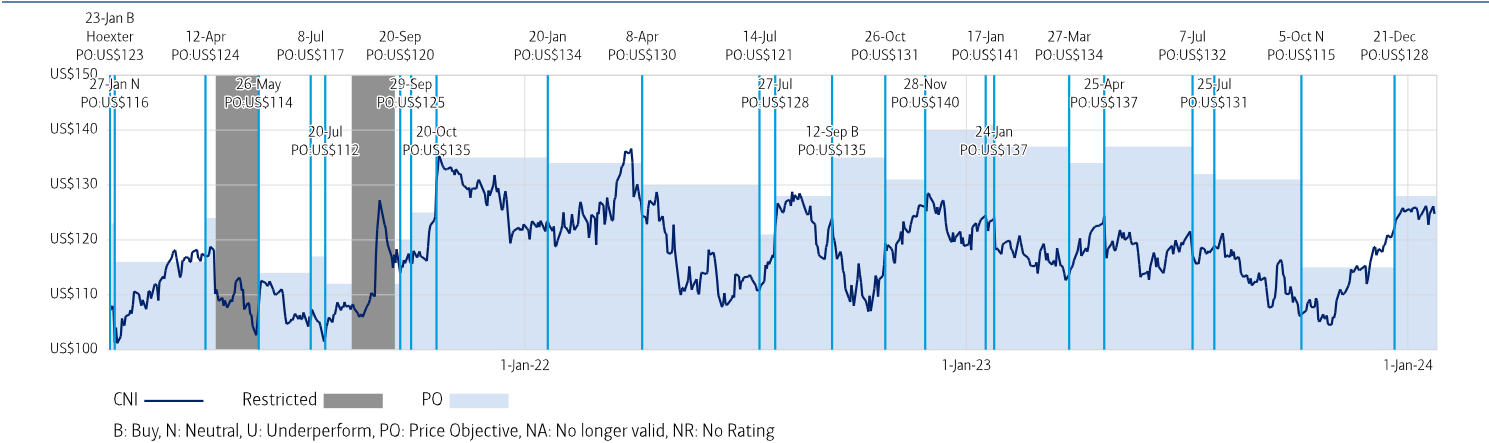
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Disclosures

Important Disclosures

Canadian Natl (CNI) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Transport/Infrastructure Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	67	50.38%	Buy	44	65.67%
Hold	31	23.31%	Hold	13	41.94%
Sell	35	26.32%	Sell	17	48.57%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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