

## Canadian National

# Reiterates flat/slight down '23 EPS; ready for gradual volume rebound; PO \$115

Reiterate Rating: NEUTRAL | PO: 115.00 USD | Price: 105.67 USD

## Maintains '23 EPS; sees 4Q q-q op. leverage on vol gains

CN posted 3Q23 EPS of C\$1.69, down 22% year-year, in-line with our forecast but below the Street's C\$1.72 estimate. The company reiterated its 2023 EPS growth target of flat to down slightly (we were down -5.4% year-year, now -4.7%) and long-term 10-15% CAGR. CFO Ghislain Houle noted a two-week West Coast port strike, flooding, and forest fires negatively impacted EPS by C\$0.10/sh, and an unfavorable fuel lag was a C\$0.10/sh headwind, which would have placed this quarter closer to C\$1.90 ex impacts. With improving volumes and operating leverage, CN expects earnings to accelerate in 4Q23. Mr. Houle targets sequential operating ratio improvement in 4Q (we forecast 210 bps better, to 59.9%), led by sequential volume gains and stable headcount. CMO Doug MacDonald is constructive on rail volumes which bottomed in July, targeting gradual improvement across bulk (Canadian grain, potash), merchandise (metals & minerals, chemicals & plastics, petroleum products), and consumer (automotive and domestic intermodal). Mr. Macdonald expects a gradual recovery in international intermodal in 2024 as the destocking cycle nears an end. COO Ed Harris, in his last call ahead of his retirement (see [succession Oct 18 note](#)), noted 3Q service was resilient despite network disruptions and challenging conditions. On-time train performance was 89% in 3Q23 (up 200 bps year-year), and car velocity was relatively stable (down 1% year-year). CN sees improved service supporting continued pricing above rail inflation.

## Core ops slightly below; slight help from tax

CN posted 3Q revenues of C\$4.0 billion, down 12% year-year, but C\$74 million above our estimate. Operating income was C\$1.52 billion, down 23% year-year, and C\$4 million below our estimate, for an operating ratio of 62.0%, a 560 bps deterioration year-year, and 90 bps worse than our forecast. A lower tax rate (23.6% vs. our 24.5% forecast) added C\$0.02/sh.

## Maintain \$115 PO

We reiterate our Neutral rating and US\$115 PO, based on 19.5x our 2024e EPS (from 20.0x), below the midpoint of its 18x-23x range given earnings headwinds. While we are positive on CN's strong service levels, we are more balanced on valuation as gains are balanced by macro pressures. We increase our 4Q23, 2023, and 2024 EPS estimates 3%, 1%, and 3%, to C\$1.87, C\$7.15, and C\$8.00, from C\$1.83, C\$7.10, and C\$7.75.

Estimates (Dec) (C\$)	2021A	2022A	2023E	2024E	2025E
EPS	5.94	7.50	7.15	8.00	8.85
GAAP EPS	6.89	7.44	7.15	8.00	8.85
EPS Change (YoY)	11.9%	26.3%	-4.7%	11.9%	10.6%
DPS	2.46	2.93	3.16	3.40	3.64
Valuation (Dec)					
P/E	22.5x	19.1x	20.3x	18.1x	16.4x
GAAP P/E	19.4x	19.2x	20.3x	18.1x	16.4x
Dividend Yield	1.8%	2.0%	2.2%	2.3%	2.5%
EV / EBITDA*	16.4x	13.7x	14.3x	13.3x	12.4x
Free Cash Flow Yield*	4.5%	4.2%	3.1%	4.0%	4.2%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 7.

24 October 2023

### Equity

#### Key Changes

(C\$)	Previous	Current
2023E Rev (m)	16,360.9	16,539.9
2024E Rev (m)	16,604.3	17,162.6
2025E Rev (m)	17,581.9	18,180.8
2023E EPS	7.10	7.15
2024E EPS	7.75	8.00
2025E EPS	8.55	8.85

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### Stock Data

Price	105.67 USD
Price Objective	115.00 USD
Date Established	5-Oct-2023
Investment Opinion	B-2-7
52-Week Range	104.62 USD - 129.89 USD
Mrkt Val (mn) / Shares Out (mn)	72,310 USD / 684.3
Average Daily Value (mn)	127.53 USD
BofA Ticker / Exchange	CNI / NYS
Bloomberg / Reuters	CNI US / CNI.N
ROE (2023E)	22.3%
Net Dbt to Eqty (Dec-2022A)	68.3%
ESGMeter <sup>TM</sup>	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"](#).

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Timestamp: 24 October 2023 10:20PM EDT

# iQprofile<sup>SM</sup> Canadian National

## iQmethod<sup>SM</sup> – Bus Performance\*

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	9.7%	11.1%	9.9%	9.8%	9.5%
Return on Equity	19.9%	23.4%	22.3%	22.4%	20.5%
Operating Margin	38.8%	40.3%	39.0%	41.1%	42.0%
Free Cash Flow	4,080	3,917	3,110	3,988	4,182

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.7x	1.3x	1.4x	1.5x	1.5x
Asset Replacement Ratio	1.8x	1.6x	1.8x	1.9x	1.9x
Tax Rate	24.0%	24.3%	24.3%	24.5%	24.5%
Net Debt-to-Equity Ratio	49.0%	68.3%	88.3%	85.9%	83.2%
Interest Cover	11.0x	12.6x	9.0x	8.4x	7.8x

## Income Statement Data (Dec)

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	14,477	17,107	16,540	17,163	18,181
% Change	4.8%	18.2%	-3.3%	3.8%	5.9%
Gross Profit	7,220	8,626	8,271	8,922	9,546
% Change	5.4%	19.5%	-4.1%	7.9%	7.0%
EBITDA	7,220	8,626	8,271	8,922	9,546
% Change	5.4%	19.5%	-4.1%	7.9%	7.0%
Net Interest & Other Income	(72)	(77)	(232)	(369)	(511)
<b>Net Income (Adjusted)</b>	<b>4,218</b>	<b>5,161</b>	<b>4,710</b>	<b>5,052</b>	<b>5,382</b>
<b>% Change</b>	<b>11.5%</b>	<b>22.4%</b>	<b>-8.7%</b>	<b>7.3%</b>	<b>6.5%</b>

## Free Cash Flow Data (Dec)

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	4,892	5,118	4,710	5,052	5,382
Depreciation & Amortization	1,598	1,729	1,814	1,861	1,906
Change in Working Capital	NA	NA	NA	NA	NA
Deferred Taxation Charge	511	404	421	492	524
Other Adjustments, Net	(30)	(584)	(552)	83	70
Capital Expenditure	(2,891)	(2,750)	(3,283)	(3,500)	(3,700)
<b>Free Cash Flow</b>	<b>4,080</b>	<b>3,917</b>	<b>3,110</b>	<b>3,988</b>	<b>4,182</b>
<b>% Change</b>	<b>23.5%</b>	<b>-4.0%</b>	<b>-20.6%</b>	<b>28.2%</b>	<b>4.9%</b>

## Balance Sheet Data (Dec)

(C\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	1,341	834	278	448	371
Trade Receivables	1,074	1,371	1,301	1,394	1,473
Other Current Assets	1,011	1,012	1,080	1,096	1,114
Property, Plant & Equipment	41,178	43,537	45,095	46,734	48,529
Other Non-Current Assets	3,934	3,908	5,651	10,578	15,730
<b>Total Assets</b>	<b>48,538</b>	<b>50,662</b>	<b>53,406</b>	<b>60,251</b>	<b>67,217</b>
Short-Term Debt	508	1,057	2,296	2,296	2,296
Other Current Liabilities	2,612	2,785	2,461	2,636	2,785
Long-Term Debt	11,977	14,372	16,336	19,061	21,561
Other Non-Current Liabilities	10,375	10,723	11,195	11,687	12,211
<b>Total Liabilities</b>	<b>25,794</b>	<b>29,278</b>	<b>32,620</b>	<b>35,912</b>	<b>38,996</b>
<b>Total Equity</b>	<b>22,744</b>	<b>21,384</b>	<b>20,786</b>	<b>24,338</b>	<b>28,221</b>
<b>Total Equity &amp; Liabilities</b>	<b>48,538</b>	<b>50,662</b>	<b>53,406</b>	<b>60,251</b>	<b>67,217</b>

\* For full definitions of iQmethod<sup>SM</sup> 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 1,232,824

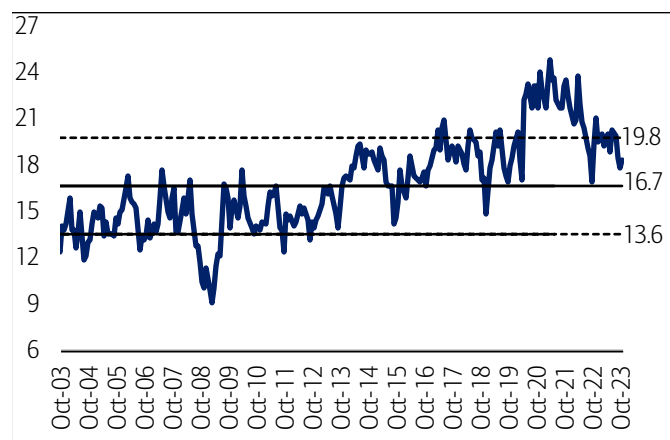
## Quarterly Earnings Estimates

	2022	2023
Q1	1.32A	1.82A
Q2	1.93A	1.76A
Q3	2.17A	1.69A
Q4	2.10A	1.87E



**Exhibit 1: Canadian National Forward P/E**

Trading at 18.4x our 2024 EPS, above the midpoint of its 14x-20x range.



Source: BofA Global Research estimates and Bloomberg.

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**Reiterates 2023 target for flat to slightly declining EPS**

Canadian National (CN) reiterated its target for flat to slightly negative adjusted diluted EPS in 2023 (we forecast -4.7%, year-year). With C\$5.27 in the first three quarters, and C\$7.50 of EPS in 2022, indicates a peak of C\$2.23, with floor of C\$1.85 (if basing on down 5% year-year). While Bulk and Merchandise volumes are posting strong gains QTD (although only three weeks into 4Q), softness in Consumer volumes, led by inventory destocking and hangover impacts from the West Coast port strikes, continue to pressure earnings.

CN's targets assume flat 2023 North American Industrial Production (from negative previously in 2Q23) and a 2023/2024 Canadian grain crop below the three-year average (inclusive of the significantly lower 2021/2022 crop year).

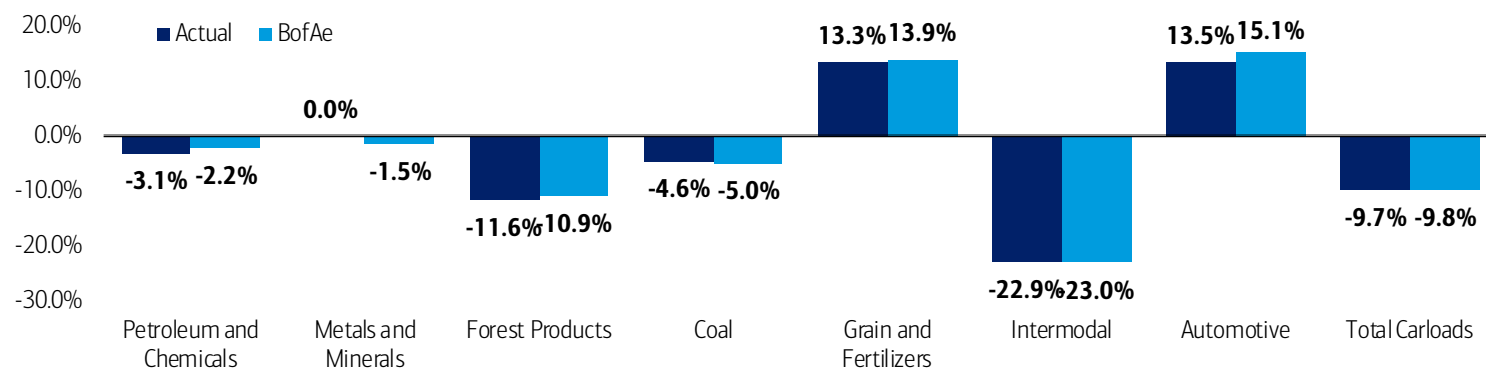
CN also reiterated its F24-F26 target of 10%-15% EPS growth, aided by a 2% CAGR North American Industrial Production, pricing above rail inflation, and increasing operating efficiency.

**Macro pressures drove volume decline, yet pricing intact**

Carloads were down 9.7% year-year, in-line with our forecast, while average revenue/carload was down 3.1% year-year, better than our forecast, as lower fuel surcharges and accessorial gains (C\$100 million headwind) were partly offset by strong core pricing moves. Chief Marketing Officer Doug MacDonald highlighted the steep decline in Intermodal as International Intermodal volumes remain impacted by the port strike at the start of the quarter. Alternatively, Domestic Intermodal monthly trends inflected positive intra-3Q, aided by its Falcon Premium service. Mr. MacDonald also noted Forest Product demand remains below pre-COVID levels due to macro impacts.

**Exhibit 2: Canadian National 3Q23 Carloads Growth**

Carloads declined 9.7% year-year, in line with our -9.8% estimate, as macro pressures and operating challenges weighed on volumes.

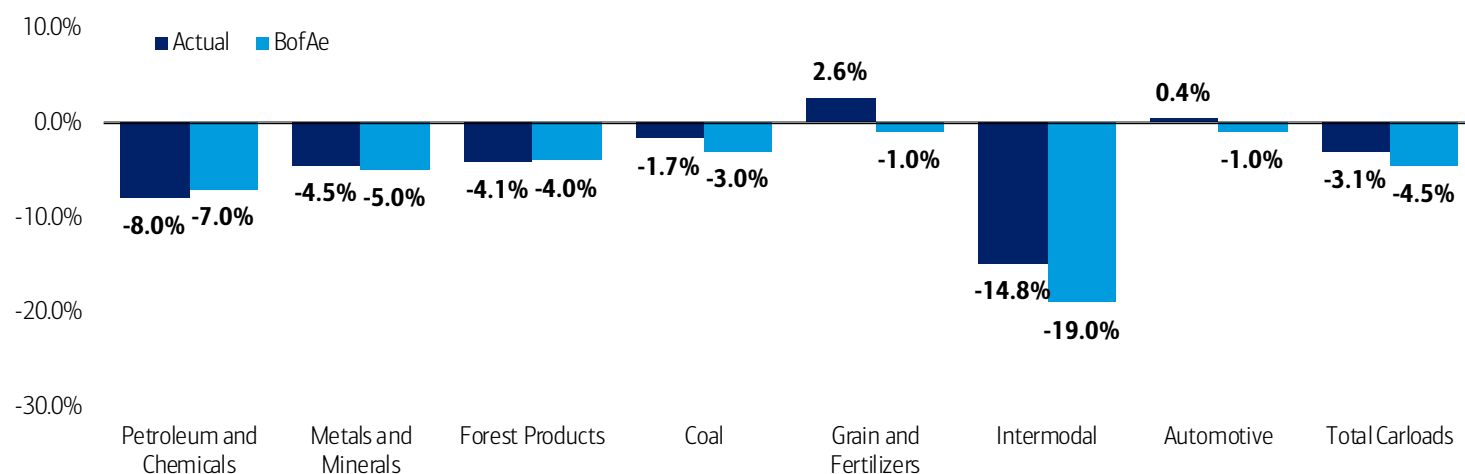


Source: BofA Global Research estimates and company reports.

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**Exhibit 3: Canadian National 3Q23 Average Revenue/Carload Growth**

Carload yields declined 3.1% year-year, better than our -4.5% estimate, as fuel surcharge lag and loss of accessorial gains were balanced by strong core pricing.



Source: BofA Global Research estimates and company reports.

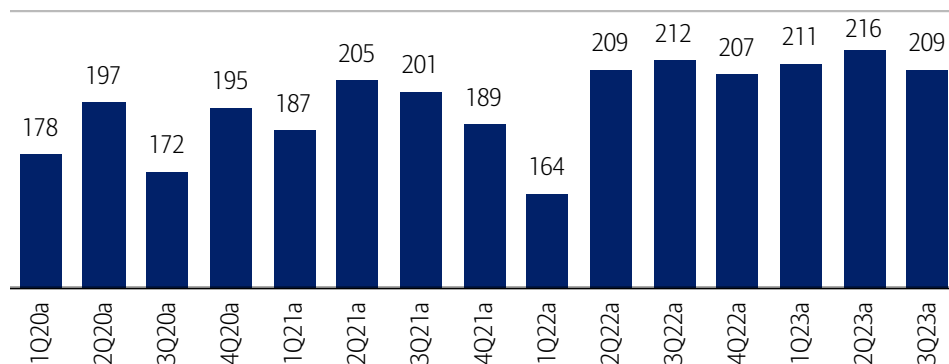
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**Service holding despite rising operating challenges**

COO Ed Harris noted the 3Q23 operating environment was one of the most challenging he has seen, with weather-related events and outages occurring on a near weekly basis. Operating headwinds included a West Coast port strike, record wildfires, and flooding across the East and West Coast. Nevertheless, service held in as freight car velocity was steady at 209 miles/car/day, down 1% year-year, and origin train performance averaged 89%, up 200 bps year-year.

**Exhibit 4: Canadian National Freight Car Velocity**

Freight car velocity was 209 miles/car/day, down 1% year-year, holding despite operating challenges.



Source: BofA Global Research estimates and company reports.

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**Bottoming volumes imply 4Q op ratio seq improvement**

CN remains highly confident that volume levels have bottomed in 3Q, as it sees a 7% sequential uptick in October volumes from September. It expects business development wins and economic recovery gains to lead a controlled ramp up to support growth.

Although 4Q-to-date revenue-ton-miles are down 1.2% year-year, CN expects volumes to rebound on an acceleration in Canadian Grain (as harvest season ramped three weeks earlier this year), elevated Potash demand (aided by export demand), strong US grain trade (aided by lower Mississippi River levels this year), and supportive frac sand demand. We forecast 4Q23 revenue-ton-miles to increase 0.3% year-year, moderating from -5.0% in 3Q23. We view a lift in volumes to concurrently drive a sequential improvement in 4Q23 operating ratio (we forecast 59.9%, a 210 bps sequential improvement).

## Price objective basis & risk

### Canadian National (CNI)

Our US\$115 price objective is based on a 19.5x multiple on our 2024 US\$ EPS estimate, just below the midpoint its 5-year 18x-23x one standard deviation trading range (at 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
<b>BUY</b>				
	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
	Old Dominion Freight Line	ODFL	ODFL US	Ken Hoexter
	RXO, Inc.	RXO	RXO US	Ken Hoexter
	Saia Inc.	SAIA	SAIA US	Ken Hoexter
	Schneider National	SNDR	SNDR US	Ken Hoexter
	Union Pacific	UNP	UNP US	Ken Hoexter
	XPO, Inc.	XPO	XPO US	Ken Hoexter
<b>NEUTRAL</b>				
	Canadian National	CNI	CNI US	Ken Hoexter
	Norfolk Southern	NSC	NSC US	Ken Hoexter
	Scorpio Tankers Inc.	STNG	STNG US	Ken Hoexter
	Teekay Tankers Limited	TNK	TNK US	Ken Hoexter
	TFI International	TFII	TFII US	Ken Hoexter
	TFI International	YTFII	TFII CN	Ken Hoexter
	UPS	UPS	UPS US	Ken Hoexter
	Wabtec Corp.	WAB	WAB US	Ken Hoexter
<b>UNDERPERFORM</b>				
	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

## **IQmethod<sup>SM</sup> 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

*IQmethod<sup>SM</sup>* 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 valuations. 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.

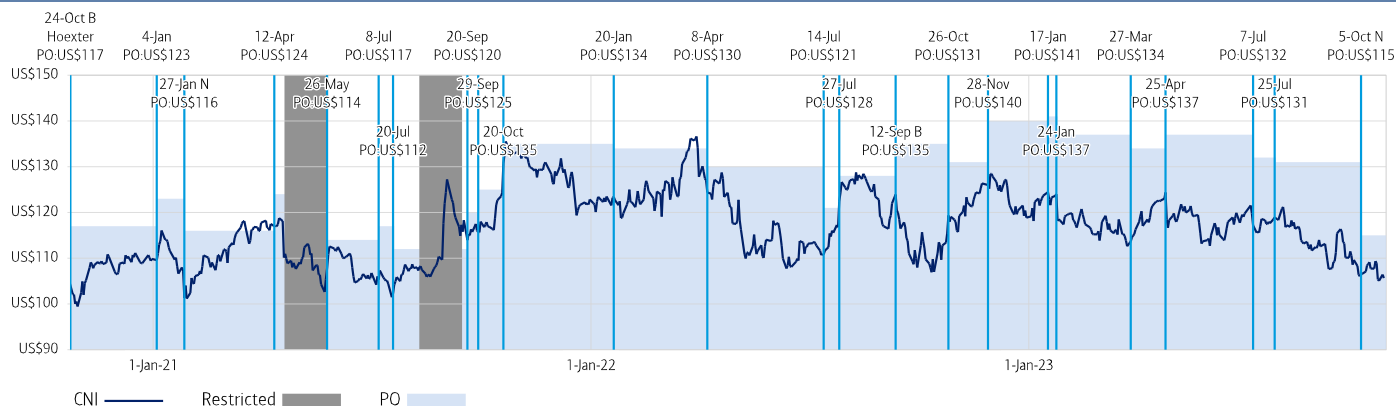
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# Disclosures

## Important Disclosures

### Canadian Natl (CNI) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	71	53.38%	Buy	43	60.56%
Hold	29	21.80%	Hold	13	44.83%
Sell	33	24.81%	Sell	17	51.52%

### Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

<sup>R1</sup> 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 <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> 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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