Equity Research

SPROTT STUDENT INVESTMENT FUND

Author 1 – David Deroode
Intern
B.Comm – Finance
davidderoode@cmail.carleton.ca

Author 2 – Daniel Cheung
Intern
B.Comm - Finance
danielcheung3@cmail.carleton.ca

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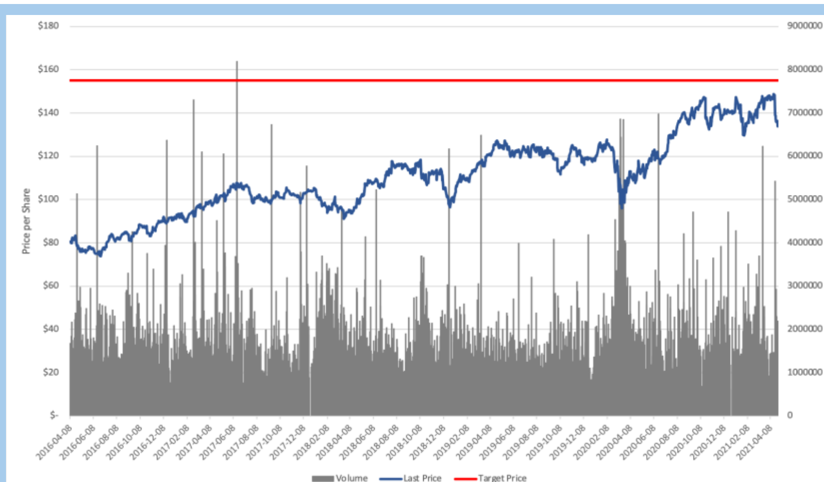
CANADIAN NATIONAL RAILWAY - HOLD



Source: Bloomberg

TSX: CNR CAD $135.85

Target Price CAD $154.92

Inside this Report	
☑ Initial Research	☐ Updated Research
☐ Price Target Change	☐ Rating Change

Research Highlights/Investment Thesis

- *Well diversified and solid long-term prospects*
  Long-term revenue growth at least in line with GDP growth and inflation
  CNR's diversified business of transporting goods in various industries is closely tied with the broader economic activity. Rail freight is the most fuel-efficient mode of transportating goods by land and is an essential service for thousands of businesses in Canada and the U.S. As a result, CNR's business is likely to be robust over the long term, as it has over the past several decades. Revenue growth over the last ten years was at a steady rate of 4.53% per year, and this rate of growth is likely to continue as both the Canadian and American economies reopen and begin to expand.

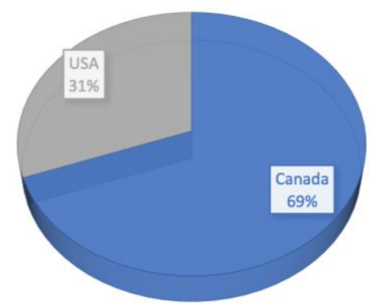
- *Industry leading innovation*
  CNR was pinoneer in Precision Scheduled Railroading (PSR), which was a breakthrough in the railway industry. PSR enabled railways to improve operational efficiencies by increasing volume transported per trip, finding the most direct routes for goods to be transported. Recently, CNR has continued to be a leader in innovation, spending more than peers on technology. CNR is looking to automate many of their operations, especially railroad inspections, which will ultimately improve operating margins, and significantly reduce the rate of preventable accidents.

Key Financial Data	
Market Cap	CAD $95.102B
S&P Credit Rating	A
Debt to Equity Ratio	0.678
Price to Earnings	27.08
EV/EBITDA	15.69
Dividend Yield	1.84%
Operating Margin	34.57%
Return on Assets	8.04%
Revenue Growth – 1yr	-7.36%

Company Outlook/Overview

Canadian National Railway (CNR) is Canada's largest railway and the third largest Class I railway in North America with respect to carload marketshare. Combined, its T-Shaped network spans across approximately 20,000 miles in Canada and the United States which connects the Pacific, Atlantic and the Gulf of Mexico. CNR's access to the Gulf of Mexico arose when they acquired Illinios Central Corp in 1999 for $2.4B. Collectively, CNR leverages 23 intermodal port locations across the span of its network, including locations such as Vancouver, Halifax, Chicago, and New Orleans in the south. CNR, founded in 1919 and headquartered in Montreal, QC employs 25,975 people to date. [1]

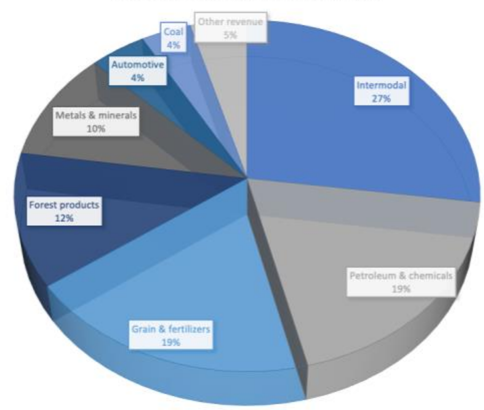
FIGURE 1: REVENUE BY REGION



Freight revenue is CNR's largest source of revenue accounting for approximately 96% of total revenue. CNR's freight revenues are generated by transporting various commodity products such as forest products, petroleum and chemicals, grains and fertilizers, metals and minerals, coal, and automotive products, as well as intermodal products. Freight services make up a diversified and balanced portfolio which allows CNR to continue performing well throughout economic fluctuations. Consolidated freight revenues were $13.22 billion in 2020.

A key aspect of CNR's strategy is to grow at a low incremental cost over the long run. To achieve this, CNR focuses on service improvements for their customers, as well as increasing productivity with technological advancements and reducing costs through acquisitions of locomotives, freight cars and shipping containers. CNR is also the most fuel-efficient Class I railroad and remains committed to reducing fuel costs and greenhouse gas emissions over the long-term. For example, technological advancements such as the anti-idling feature in its new locomotives contributes to improvements in fuel efficiency.

FIGURE 2: REVENUE BY SEGMENT



[1] Canadian National Railway: About Us Page

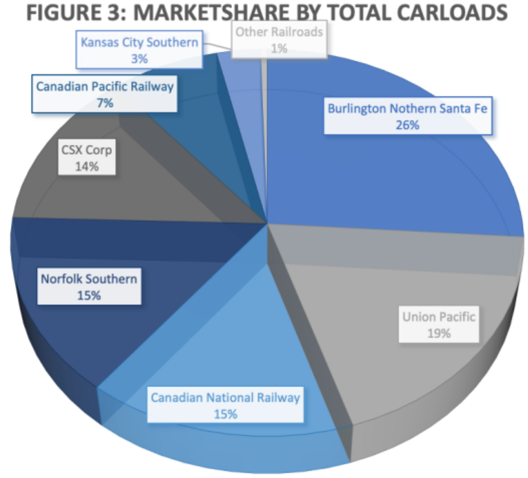
Industry Analysis

Market Size and Structure

The freight railroad industry is highly concentrated with the top 10 companies making up approximately 84% of total industry revenue.[2] Within Canada, Canadian Pacific (CP), and CNR compete in a highly concentrated market, accounting for 33.1% and 58.0% of the $17 billion market respectively, The U.S. total market is shared between 7 main operators (Figure 3), which is approximately $66 billion in market size.[3] Canadian National Railway operates among 6 other large railway companies in North America. It is worth mentioning that although 7 railroads dominant the overall North American market, the market is really broken down by 3 duopolies competing in the west, east and central part of North America. CSX and Norfolk Southern compete in the east, Canadian Pacific and Canadian National compete in Canada, and finally, Burlington Northern Santa Fe LLC and Union Pacific operate in central and Western America. The overall industry is led by Burlington Northern Santa Fe LLC in terms of total carload volume as seen in Figure 3. Burlington Northern Santa Fe LLC is parent company of the BNSF Railway and wholly owned subsidiary by Berkshire-Hathaway.

As mentioned, Canadian Pacific, the other Canadian Class I railway operates a 15,000-mile network in competition with CNR within the Canadian market. Both railroads cover territory from east to west coasts within Canada, however CNR reaches additional destinations such as Halifax in the east, and the Gulf of Mexico in the south. Moreover, CNR has exclusive access to the Port of Prince Rupert in BC, and bypasses much of Chicago's congestion which limits many others in delivering goods.[4] CNR's exclusive access to the port in Prince Rupert is due to the tight and limited space available to build railroad infrastructure. CNR developed the port a century ago and it continues to serve as a key intermodal terminal for CNR which receives many shipments from

FIGURE 3: MARKETSHARE BY TOTAL CARLOADS



Source: Bloomberg CNR has increased market share from 14.21% in 2018 to 15.46% in 2020

[2] BCG's Transportation and Logistics Marke

[3] IBIS World: Rail Transportation in the US

[4] BI: Canadian National Railway: Company

international destinations, particularly Asia.

Within the industry, competitors seek to increase market share by generating greater efficiencies that translate to cost savings for customers, as well as expanding existing railroad networks to service a wider range of locations to ultimately target new market opportunities and customers that may be leveraged as unique competitive advantages. Precision scheduled railroading (PSR), a strategy that was pioneered by CNR, has now been adopted by most Class I railroads in the past decade to increase transportation efficiencies. The goal of PSR philosophy is to optimize freight transportation through identifying the most direct routes, reducing the number of individual locomotives, and increasing the volume carried in a single trip.

Companies focus on developing freight solutions that can deliver products to their end destination in a quicker manner. Intermodal transportation, the use of two or more modes of transportation in the process of delivering goods is a great example of a key industry movement that can be traced back to the 1960's. Typically, once goods arrive on land from ship, intermodal terminals utilize automation to precisely schedule container pickup times. Containers are then typically picked up by rail, transported in longer distances cross-coutry to nearby its end destination, then transferred by truck to finalize the delivery, all in a seamless process for the customer. Intermodal has ultimately cut the time associated with transporting goods, and thus led to greater operational efficiencies. Intermodal is ideal as it leverages the speed and efficiency of rail, yet also uses the locality and convenience of trucking in tighter, and more densely populated areas. Among the freight services offered, many of the transported goods range from agricultural, industrial/commercial, and consumer products. Consumer products such as fruits and vegetables, refrigerated goods, and dry goods such as apparel, electronics and pharmaceuticals make up a large portion of intermodal revenue.

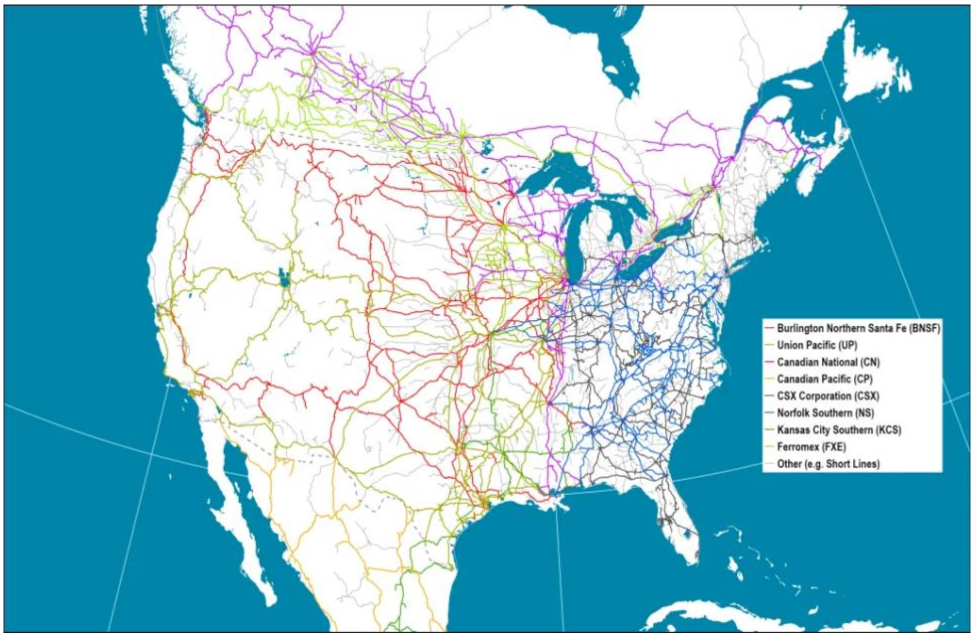
Moat

CN has a wide economic moat due to cost advantages, specifically with scaling advantages. This is due to the large amount of capital, fixed costs and time required to enter the realm of Class I railway networks within Canada. Railroad classifications include Class I, II, and III. These classifications are given to railroads based on annual operating income, adjusted for inflation. The current threshold to be classified as a Class I railroad in North America is roughly $500 million in annual operating income. There are 7 Class I railroads in Canada. CN, now strives to expand its large network through mergers and acquisitions which results in greater sources of revenue. CN has exclusive access to the Port of Prince Rupert, which is the third busiest seaport in Canada with annual cargo tonnage at 29.84 metric revenue tons.[5] This gives CN an edge over other competitors. Rail transportation is also considered one of the most fuel efficient and cost friendly means of transportation. A single freight train can replace over 300 trucks due to the

[5] Port industry Statistics. (n.d.). Retrieved March08,2021, from https://www.aapaports.org/unifying/content.aspx?ItemNumber=21048

train length and capacity which allows trains to carry much more volume per gallon of fuel.[6] Moreover, rail is 4 times more fuel efficient than trucking and produce 75% less greenhouse gas emissions. [7]CN has also developed a brand throughout their years in operations, which is recognized as a reliable transporter of goods.

Competitor Analysis



Ownership of Major North American Rail Lines[i]

Canadian Pacific

Canadian Pacific (CP) is the smaller Class I railway that competes in a duopoly with Canadian National in Canada. Based in Calgary, AB, CP operates on about 24,000km in track, while being heavily skewed towards Western provinces. In 2020, CP's total revenue was $7.54B, with industrial and consumer products being the largest revenue drivers. Freight products transported by CP are mostly identical to those of CNR. CP's market cap is roughly $63B.
Recently, Kansas City Southern, an American Class I railroad has agreed to enter a merger with Canadian Pacific at a deal valued at USD$29B, which includes $3.8B of KCS's debt[8]. If approved by the Surface Transportation Board, the duo would combine to create a 20,000-mile rail network, becoming the first railroad system to connect Canada, US

[6] Canadian National Railway: Emissions: Environment: Delivering responsibly
[7] Bloomberg: CP RAIL AGREES TO BUY KANSAS CITY SOUTHERN FOR $275 A SHARE
[8] Bloomberg: CP RAIL AGREES TO BUY KANSAS CITY SOUTHERN FOR $275 A SHARE

and Mexico. Created synergies are expected to total $780M in the next 3 years. [9] The merger will allow CP to tap into the Mexican market, which accounted for 48% of KCS's revenue in 2020, and will provide greater cost efficiencies in transporting freight from Mexico to Canada and vice versa.

Union Pacific

Union Pacific, based in Omaha, Nebraska, is the second largest Class I rail operator in the US, with a network consisting of 32,300 rail miles in 25 states in the western-two thirds of the US.[10] UNP has a market cap of $187B. In 2020, UNP generated $19.53B in revenue, 89.2% of which was derived from the US, while the other 10.8% was generated from Mexican operations.

Kansas City Sothern

Kansas City Southern (KSU), a smaller Class I railroad in the US is based in Kansas City, Missouri with a market cap of roughly $30B. KSU's operating footprint consists of approximately 7100 miles in track, 3800 miles of which rests in Mexico. In the US, KSU has strong saturation along the East Coast. In 2020, US operations only totaled 52.7% of the $2.63B in total revenue while Mexico accounted for 47.9% of revenue.

Norfolk Southern

Norfolk Southern Corp, headquartered in Norfolk, Virginia, is another Class I rail company who transports freight over a 20,000-route mile network in more than 20 states, primarily skewed towards the East coast of the US. Coal is Norfolk's largest single commodity group. In 2020, Norfolk's total revenues, derived from transporting freight were $9.789B. Norfolk has a market cap of $85.75B

CSX

CSX Corp is another large Class I railroad company with a market cap of $74.89B. Headquartered in Jacksonville, Florida, CSX operates a major rail system of around 19,000 route miles in the eastern US.[11] The company reaches Ontario and Quebec in addition to 25 other US states, utilizing 70 ports. Freight transported by CSX includes very similar products compared to CNR. Namely, merchandise like food and agricultural products, chemicals, and coal and automotive products. CSX's revenue in 2020 totaled $10.58B USD, with chemicals being the largest driver at 21.8%.

Ticker	Name	Mkt Cap (CAD Billions)	Rev - 1 Yr Growth	EPS - 1 Yr Growth	P/E	ROE	Dividend 12M Yld %
Median	Median	89.66	-9.08	-6.11	27.83	20.92	1.24
CNI US Equity	**CANADIAN NATL RAILWAY CO**	**104.69**	**-7.36**	**-11.53**	**24.85**	**20.08**	**1.53**
CP CN Equity	CANADIAN PACIFIC RAILWAY LTD	62.79	-1.05	7.45	26.65	33.4	0.78
UNP US Equity	UNION PACIFIC CORP	186.55	-10.02	-3.18	27.55	31.35	1.74
CSX US Equity	CSX CORP	93.57	-11.34	-10.98	27.83	21.76	1.08
KSU US Equity	KANSAS CITY SOUTHERN	29.89	-8.14	0.75	38.81	15.01	0.68
NSC US Equity	NORFOLK SOUTHERN CORP	85.75	-13.34	-9.04	29.61	15.73	1.4

Source: Bloomberg

[9] Bloomberg: CP RAIL AGREES TO BUY KANSAS CITY SOUTHERN FOR $275 A SHARE
[10] Bloomberg: UNP Overview
[11] Bloomberg: CSX – Company Overview

Porter's Five Forces

Competitive Rivalry

In Canada there are two major national railroads that compete in a duopoly. These two are Canadian Pacific and the Canadian National Railway. Competition is based on reliability and quality of transport services provided, access to markets, as well as price. Customers' flexibility in choosing between various sources and destinations for products also affects railroad performance. Although there are only two major national railroads in Canada, these railroads each have access to the same major industrial areas, commodity resources, and major populations, meaning that they compete on quality and price of services provided. Over the last 10 years, CNR has been able to grow its total North American market share from 10.9% in 2010 to 13.0% in 2020, whereas its rival Canadian Pacific has seen decreased market share, from 7.1% in 2010 to 7.4% in 2020. This shows that CNR's strategy has proven to be successful in acquiring customers and expanding market share. In the U.S., the railroads face a consolidated market, and large rail systems that compete effectively with each other. Like in Canada, multiple railroads typically serve similar major industrial areas and resources. There is also a larger number of railroads operating in the U.S.

Exchanges rates and energy costs affect customers' choices on where to source and deliver their goods, and these factors are especially important for railroads that serve both the U.S. and Canada.

Threat of New Entry

It takes enormous amounts of money to build and maintain a railway. In addition, the competitiveness of a railroad is directly related to their geographical coverage and costs of delivery. Established railroads have been building both things for a long time which makes it impossible to obtain quickly as a new railroad company. The infrastructure required to build a large and profitable railroad takes too much capital and time. Furthermore, it is impossible for new entrants to obtain the rights to access existing railways which makes it even harder to compete against other Class I railroads. As a result, there is almost no way for new entrants to get any substantial foothold in this mature market.

Threat of substitution

In addition, there are few if any viable alternative intercity transportation options available to companies who need their goods shipped in bulk. Railroads remain the most efficient way of moving large amounts of cargo on land. The only other major alternative is truck transportation, which is limited in terms of the amount of cargo that can be transported in one truck, not to mention the higher accident rates associated with trucks. However, trucks have a competitive advantage over rail in that trucks can use public roads that are maintained by public entities, whereas railroads need to build and maintain their own tracks. However, railroads, CNR included, have begun to expand through the acquisition of trucking companies as part of an effort to enhance their intermodal transport services. In addition, due to recent developments in emissions regulations, the trucking industry is facing cost difficulties. Finally, the large volumes that can be shipped via rail often makes rail cheaper than trucking and makes rail transport inherently more fuel efficient. Other alternatives such as air freight remains costly and difficult to coordinate.

Buyer Power

Buyer power is relatively low. Railroads remain one of the most efficient and safe ways to transport goods by land. In addition, railroads typically have few direct competitors, and if one railroad can serve a location that its competitors are unable to serve, there is no easy way for the competitors to respond. This leaves clients very little choice but to use the one railroad that is currently serving that region. Because of these factors, railroads can usually set their own prices and adjust them based on inflation.

However, buyers do have power in the fact that they can choose where they source their products, and what products to use (e.g., natural gas vs. Coal). This can lead to reduced shipping volumes for certain products, and thus lower revenues for railroads. Due to this possibility, railroads typically offer their services to a very broad base of clients, in order to diversify their operations and reduce the impact of changes in buyer sourcing.

Supplier Power

Supplier power is medium to low. The complexity of rail equipment makes the number of suppliers that railroads can choose from limited. As a result, railways maintain long-term relationships with their suppliers, and are subject to any changes in the services or product offerings of their suppliers. This in turn could result in higher costs for a railway and/or difficulty in obtaining the equipment needed for operations. However, due to the specialized nature of the equipment, suppliers of such equipment have a significant portion of their business dedicated to serving railways. Many railways also have foreign suppliers, meaning that international relations, trade restrictions, and other global events can adversely affect their ability to obtain needed equipment.

Industry Dynamics

Intermodal Transport

Intermodal transport has become increasing important in the last decade. For the past several years, intermodal transport has been the largest portion of CNR’s revenue, making up 27.1% of its total revenues in 2020. Over the last ten years, CNR’s revenues for this segment of its business has grown at an average annual compounded rate of 7.7%. Intermodal transport involves the use of containers that can be loaded onto a variety of transportation vehicles, such as truck, rail, or boat to ship goods to their respective destinations. Goods being delivered via intermodal transport are typically picked up first by truck, then loaded onto rail. From there, it is either sent to a terminal nearest to the goods’ destination, and then delivered by truck, or it is loaded onto a port to be shipped overseas.

Intermodal transport allows companies like CNR to provide more efficient transport services, as well as giving them the opportunity to offer an end-to-end rail supply chain solution to their customers. Recently, CNR has made a series of acquisitions in order to strengthen its position in the intermodal business, including a $192 million acquisition of TransX, a transportation and logistics services company, and a $105 million acquisition of the intermodal temperature-controlled division of Alberta-based H&R Transport Limited. Both acquisitions were completed in 2019.

Petroleum and Chemicals

Petroleum and chemicals make up the second largest portion of CNR's revenues (19% in 2020). These include plastics, refined petroleum products, crude and condensate, and Sulphur. The COVID-19 pandemic caused demand for these products to drop sharply, and with global environmental initiatives to reduce demand for petroleum products, revenues from this segment of the business are likely to fall in the long run. However, in the short to medium term, the demand for oil and related products will recover from the downturn caused by the pandemic, although they will probably settle at levels lower than before the pandemic. Pipelines have been recently transporting almost all oil produced in Canada (CEPA, 2020). However, with slowdowns in upgrading old pipelines and the recent difficulties of building new ones, Canada will likely increase investment in rail transport of oil. If this does indeed prove to be the case, the result may be an increase in volumes and revenues for CNR.

Metals and Minerals

Demand for metals and minerals are driven by the health of the overall economy and are inherently cyclical. As with many of CNR's segment, revenues from this segment dropped in 2020 due to the COVID-19 pandemic, however, in the short to medium term, demand for metals and minerals are expected to increase as the economy continues to rebound. In the long run, the metals and minerals industry will continue to be a significant component in Canada's economy, as it fuels agriculture, construction, and various other essential products and services.

Grains and Fertilizers

Due to industrialization and urbanization, the amount of arable land in North America and around the world has been steadily decreasing. Given the world's growing population, this puts pressure on existing farmland to continue to produce as much as, or even more than it is currently producing. As a result, long-term demand of fertilizers, and especially biofertilizers, are expected to continue to be strong.

Looking to the grains market, we find that overall Canadian production of grains in 2020 were at a record high. Currently, we are seeing high agricultural commodity prices, which should result in a higher Canadian crop supply in 2021, in turn driving up demand and prices for fertilizers. CNR themselves are anticipating an all-time record crop this year. However, a stronger Canadian dollar may lead to worse margins for exporters, and Canadian producers losing their competitive advantage (Farm Credit Canada, 2021). That said, the short to medium term outlook for the grain industry is positive, which is good news for CNR.

In the long-run, demand for grains and fertilizers will remain strong, but extreme weather events and the uncertainty that comes with climate change may have an adverse impact on farmers, and in turn on CNR's general operations. In 2020, 19% of CNR's revenues came from this segment.

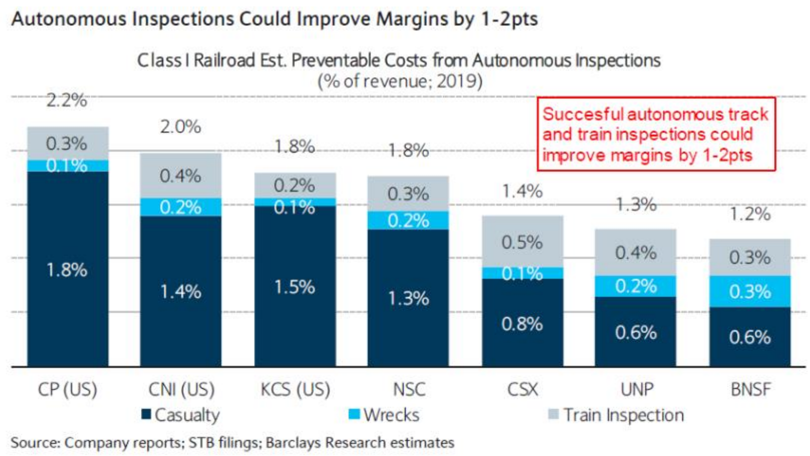
Growth and Risk Analysis

Growth Outlook

Technological advancements leading to incremental operational efficiencies.

CNR has managed to drive operating ratios lower through technological advancements integrated into operations, making CNR the most fuel-efficient Class I railroad. Examples that contribute include anti-idling features for locomotives that help improve fuel efficiency, a large cost incurred by all railroad companies. Additionally, CNR's technology investment regarding an automatic inspection portal can inspect a 120-car train in 2 minutes, which is the same amount of time it takes to manually inspect a single car. In addition, CNR's automatic track inspection cars can inspect 60 miles of track per hour, compared to the current rate of 60 miles per day. [12] Automation also continues to offer efficiencies for CNR. Automation has helped intermodal terminals become more efficient, productive, and precise at scheduling its container arrival and departure times which enables CNR to strategically place containers for easier access when needed. Prior to automation, scheduling was typically performed by hand on paper, which produced more errors and was less efficient than automation initiatives. The use of data analytics can help railroaders find defects in equipment prior to them materializing into safety, operational and financial issues.[13]

Precision scheduled railroading (PSR) is also another advancement that has been adopted by a handful of Class I railroads including CNR, CP, Union Pacific, Kansas City Southern, Norfolk Southern and CSX. PSR is a philosophy used to drive greater efficiencies by focusing on the scheduled point-to-point deliveries, and really homing in on delivering the product to the end destination in a timelier fashion compared to past methods. It's worth mentioning that BNSF has not implemented PSR. Although some technological advancements may be considered minor, innovative technological advancements have proven to incrementally increase productivity and efficiency in the long run for CNR, leaving investors with more earnings per share. As technology initiatives continue to present opportunities for CNR, operating costs are currently on track to experience a reduction of $400 million by 2022, which is roughly 4.42% of total 2020 operating expenses ($9.042 billion). CNR, an early adaptor of PSR is now focused on increasing volumes and incrementally improving effieciency margins over the long run through technological advancements.



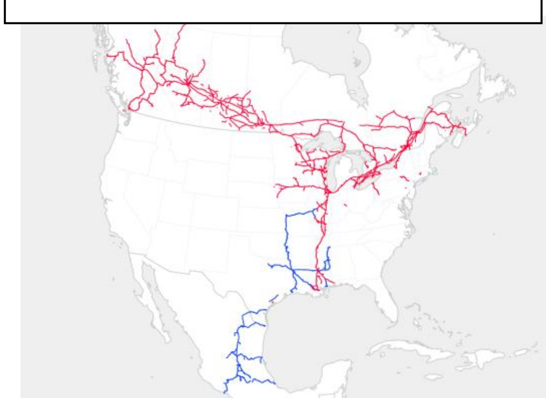
[12] BI: Canadian National Railway: Company Outlook
[13] BI: Technology Enhancements Inside and Out

[14]

Intermodal expansion projects allowing for more total volume.

On average, CNR's intermodal segment has made up 22% of revenue over the past 10 years. This is CN's largest source of revenue, and we also expect this trend to continue for the next 5 years. Intermodal transportation, as mentioned previously, is the process of utilizing more than one means of transportations to transport freight. For example, the combination of trucking and rail transportation. CNR has led some intermodal projects that have led to increases in total cargo volume. CNR has advantages compared to competitors thanks to exclusive access to a port in Prince Rupert. Ongoing port expansion in Prince Rupert, Halifax, Vancouver, and Montreal is allowing for more total volume to pass through their intermodal terminals. Namely, the port of Prince Rupert is expected to increase total capacity to 1.8 million cargo units by 2023, up from 1.35 million in 2018. [15] The Prince Rupert Port provides the quickest access to international locations, namely Asia, which is ultimately driving intermodal growth. CNR's average revenue per intermodal shipping unit is $1,453, which is 35% more than the average for other public Class I railroads. The larger margin is primarily attributed to long haul shipment destinations in which CNR transports a majority of their good.[16] Recently, total intermodal carloads surged by 19.3% compared to 1 year ago due to robust flow of imports and tightening trucking capacity. CNR led peers with a 37% increase in volume from last year due to their exposure along the Pacific, where most import demand occurred. Moving forward, prolonged restocking cycles fueled by e-commerce and trending increases in consumer spending on goods is expected to continue fueling intermodal freight growth. [17]Additionally, intermodal growth is expected to continue due to a tightening truck market making intermodal a key winner in terms of cost. Given that intermodal transportation is roughly 10- 30% less expensive than trucking, it is becoming perceived as a more efficient way to transport goods. The seemless intermodal experience appears to be transfering truckloads to intermodal. Conclusively, port expansions in Vancouver, Prince Rupert, Halifax, Montreal and the Gulf of Mexico, along with the tighter trucking market and increased demand for goods should continue to drive intermodal volume capacity, in turn driving topline growth for CNR.

CN and KSU Combined Network



Possible merge with Kansas City Southern.

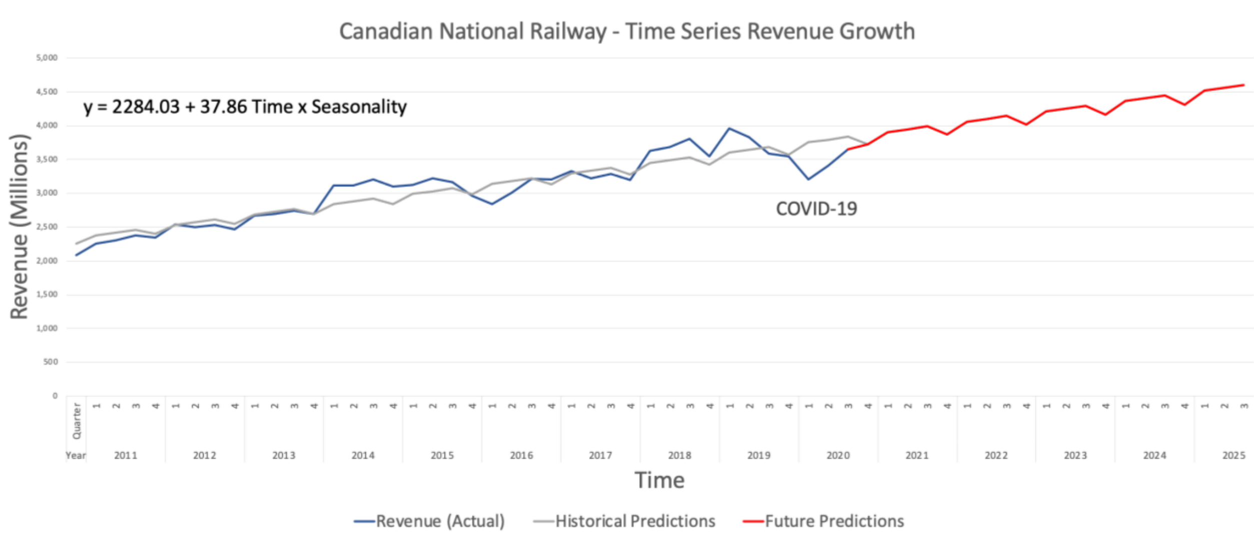
On April 20, 2021, Canadian National placed a bid on Kansas City Southern for $30B USD which represents a 21% premium over Canadian Pacific's $25B bid announced on March 21, 2021. CN has offered to compensate KSU shareholders with $200 in cash, and an additional 1.059 shares of CN. To successfully merge, CN requires approval from the Surface Transportation Board (STB) which management expects to check out,

[14] Canadian National Railway - BULL & BEAR DEBATING FREIGHT 2020, Barclays, 2020
[15] BI: Canadian National Railway: Company Outlook
[16] Canadian National Railway: Investor Presentation 2021
[17] BI: Rails Recover From Winter with Bright Spots in Intermodal, Coal

however combining the two railroads would create a very large network in North America, and thus is subject to significant scrutiny and analysis in determining the impact on free market competition. The successful merge if approved by STB would open CN's doors to Mexico which is highly valuable for few reasons. First, economic recovery from the pandemic has gained momentum and U.S. manufacturers struggling with stagnant Asian supply chains have begun turning to Mexico for sourcing. [18] Additionally, the reworked free-trade agreement between Canada, United States and Mexico (CUSMA) has strengthened economic ties between the countries meaning key stakeholders such as businesses can benefit from free-trade, which is expected to drive intercountry demand for transportation services. [19] Lastly, the recent election of U.S. President Joe Biden is likely to supply the economy with steadier cross-border relations which were trumped by the former president. Combining the two railroads is projected to result in EBITDA synergies of $1B annually, mainly derived from additional revenue opportunities.[20] A significant portion of these synergies (70%) is expected to come from converting truck traffic from busy highways to rail for better fuel efficiency at lower costs.

Volume driven higher by vaccination progress and population growth.

COVID-19 had a material impact on the North American economy, which resulted in a 7.95% drop in CNR's revenue year over year from 2019 to 2020. This temporary activity caused a sharp decrease in the demand for industrial goods and total volume of rail transportation services. Economic shutdowns in 2020 resulted in a 45% decrease in consumer spending from 2019.[21] As nation-wide lockdowns and restrictions begin to lift in Canada given the widespread vaccination progress, forecasts suggest consumer spending on products and services will increase, leading to a 4% increase in Real GDP in 2021. [22] As businesses begin to adapt to growing demand for products,



[18] Bloomberg: K.C. Southern Morphs From Rail Also-Ran to $30 Billion Prize
[19] Government of Canada: CUSMA
[20] Canadian National Railway: CN Makes Superior Proposal to Combine with Kansas City Southern
[21] IBIS World: Business Environment Profiles, Consumer Spending Canada, 2021
[22] Passport: Economic Reports, Canada, 2020

demand for industrial products could also rise, resulting in a gradual return to pre-pandemic demands for rail services. Additionally, the Canadian Government has announced they aim to increase the Canadian population at a rate of 1% of current population per year from 2021 to 2023. This includes around 401,000 immigrants welcomed in 2021, 411,000 in 2022, and 421,000 in 2023. [23] The increasing population could pose positives for the broader Canadian economy, allowing CNR to capitalize on the growing economy.

Risks

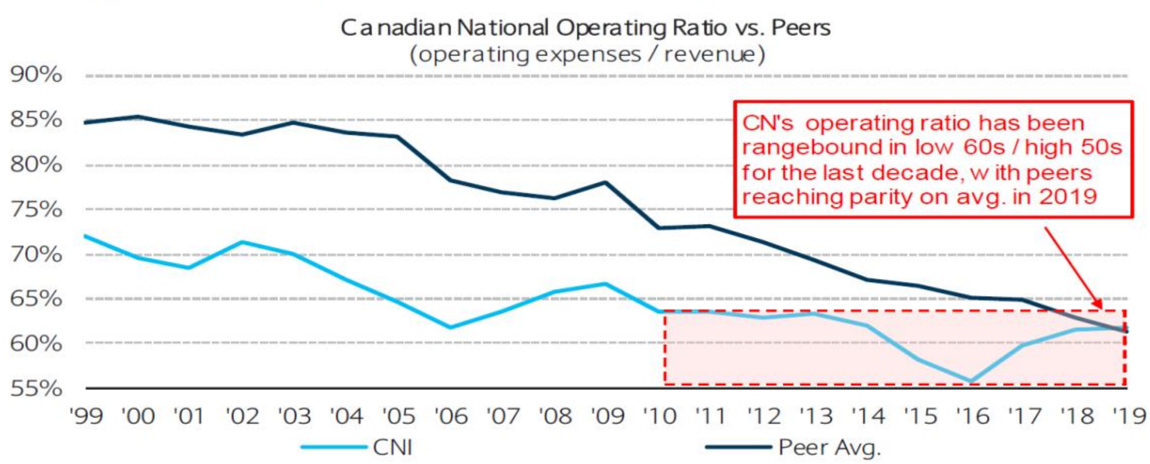
Competition

CNR faces significant competition from Canadian Pacific, the other major railroad that operates within Canada. Both railroads service many of the same major industrial areas and populations. CNR also competes against other Canadian and US railroads, trucking companies, transportation via the St. Lawrence-Great Lakes Seaway, and transportation via pipelines. The industry typically competes on quality of service, access to markets, and price, and any improvements to services provided by competitors will result in tougher competition, which may lead to a decrease in revenues and profit margins for CNR. Although CNR has been gradually gaining market share in the industry and has long been seen as an industry leader in terms of innovation and operational efficiency, more recent developments indicate that competitors are beginning to catch up. In addition, the recently announced Canadian Pacific - Kansas City Southern merger will become, if completed, the first rail network to connect Canada, U.S. and Mexico without any intermediary. This will make competition both within Canada and the U.S. tougher for CNR.

Failure to Improve Margins

CNR has long been an industry leader in terms of profitability and had higher margins than many peers. However, in

CN Margins Now at Parity With the Rest of the Industry



Source: Company reports; Barclays Research

[23] Government of Canada: Immigration, Refugees, and Citizenship Canada

recent years, other railroads have brought up their margins, and CNR's margins are now only on par with the industry average.

The fact that other peers are catching up by operating at a lower cost means that the competitive landscape for CNR is becoming more difficult for the company to navigate. In addition, it seems clear that the industry has come to a point where margins are difficult to improve upon. This means that growth through the expansion of revenues has become key for railroads like CNR.

[24]

Risk of Future Economic Downturns

CNR's business is based largely on commodities whose volumes of production go through irregular cycles, driven by changes in demand. These changes in volume have a material impact on CNR's revenues. Volatility in the energy markets, for example, could impact demand for transportation services, and also have an impact on fuel costs for delivering transportation services. An overall decrease in business demand could have a negative impact on demand for CNR's services, and thus lead to lower revenues and profits. For example, 2020 was one such year when business demand shrunk significantly, leading to a 7% decrease in revenues compared to 2019.

Trade restrictions and regulations

Trade restrictions and regulations imposed on trade from countries overseas may adversely impact CNR's ability to access needed equipment.

CNR operates a multinational business, providing services to customers in Canada and the U.S. Changing regulations between the trade of the two countries may have an adverse impact on CNR's operations through the form of increased tariffs, or lower volumes travelling between the two countries. With the recent implementation of USMCA, trade between Canada and the US is not likely to deteriorate significantly, although the new agreement is still a work in progress.

Management

The President and CEO of CNR is Jean-Jacques Ruest. Ruest is 65 years old and was appointed as the CEO in July of 2018 after serving as both the Executive Vice-President and the Chief Marketing Officer since 2010. Jean joined CNR in 1996, after working for 16 years at a major national chemical company.[25]

[24] Canadian National Railway - BULL & BEAR DEBATING FREIGHT 2020, Barclays, 2020
[25] Canadian National Railway: CEO and Direct Report

Inside Ownership

Currently, only 0.20% (1.42M) of outstanding shares are held by insiders. Collectively, the top five insider positions own 0.13% of total outstanding shares. The largest position is held by Robert Pace, CNR board member. Pace's position is currently a total of 345,775 shares, valued at approximately $50.8M CAD (0.05%). Next, Jean Jacques-Ruest, President and CEO owns 185,758 shares or 0.03% of shares outstanding. The third largest position is held by board member Denis Loiser who owns 167,254 shares (0.02%). Many of the latest changes for insiders has resulted in additions to their positions. For example, CEO Jean Jacques recently added 18,700 shares to his position, the largest increase of all listed insider ownership. [26]

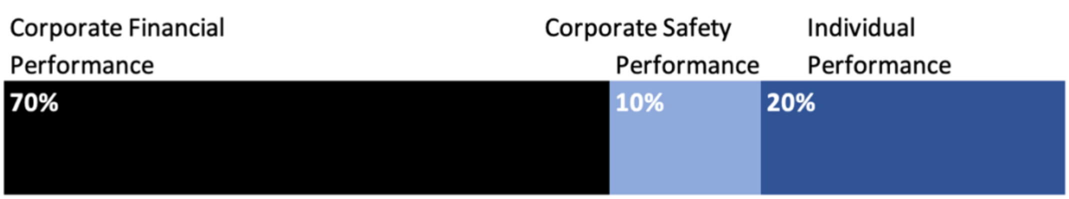
Inside Ownership: CNI

	Insider Name	Position	Latest Chg	Filing Date	% Out
1	Pace Robert L	345,775	6,130	2/2/2021	0.05
2	Ruest Jean-Jacques	188,327	2,569	3/17/2021	0.03
3	Losier Denis	167,254	-2,000	3/24/2020	0.02
4	Kempston Darkes V Maureen	142,192	1,952	2/2/2021	0.02
5	Houle Ghislain	105,432	1,590	3/17/2021	0.01
6	Carty Donald J	83,196	2,860	2/2/2021	0.01
7	Finn Sean	73,468	0	3/19/2021	0.01
8	Holiday Edith E	62,937	1,939	2/2/2021	0.01
9	Giffin Gordon D	44,009	1,955	2/2/2021	0.01
10	O'Connor James E	34,148	1,962	2/2/2021	0
11	Stein Laura	28,229	3,620	2/27/2020	0
12	Lynch Kevin G	28,066	2,582	2/27/2020	0
13	Ryhorchuk Doug	25,855	840	3/17/2021	0
14	Drysdale Janet	13,466	-2,000	3/18/2021	0
15	Reardon Keith	13,236	501	3/17/2021	0
16	Macdonald Doug	13,200	291	3/17/2021	0
17	Godin Julie	13,125	3,252	2/27/2020	0
18	Phillips Robert L	10,648	1,200	3/8/2021	0
19	McKenzie Margaret A	1,675	1,200	2/3/2021	0
20	Bruder Shauneen Elizabeth	1,200	0	2/2/2021	0
21	REILLY ROBERT	788	788	3/17/2021	0
22	Cairns James	746	-1,115	3/18/2021	0
23	Klein Dorothea	456	371	3/17/2021	0
24	Reilly Robert	305	305	3/30/2020	0
25	Malenfant Dominique	252	181	3/17/2021	0
26	Madigan Kimberly A	21	0	12/6/2019	0
Total		1,398,006	30,973		0.17

Executive Compensation

CNR's executive compensation program is comprised of 4 factors including a base salary, annual incentive bonus, long-term incentives and pension benefits and executive prerequisites as seen below. Base salaries are determined based on industry comparatives such as Union Pacific, CSX Corp., Norfolk Southern Corporation and Canadian Pacific Railway. In 2020, the annual incentive bonus was structured so that 70% of which was tied to corporate financial performance, 10% to safety performance and 20% for individual performance as seen below. The annual bonus is designed to reward the achievement of corporate financial performance and safety metrics in the annual performance period. In 2020, the CEO and President, JJ Ruest received a total compensation of $10.813M. [27]

Annual Incentive Compensation Breakdown



Additionally, long-term incentives are broken down by 55% in Performance Share Units (PSU's), and 45% in stock options. 70% of the PSU value is subject to the attainment of three-year average ROIC targets and to the attainment

[26] Bloomberg: Canadian National Railway – Inside Ownership
[27] Canadian National Railway: 2021 Management Circular

of a minimum average closing share price determined at the beginning of the cycle. The other 30% of PSU value is subject to CNR's relative performance against select Class I railroads and the S&P/TSX 60 companies. [28] The remaining 30% of long-term incentive compensation consists of conventional stock options that vest over a 5-year period at a rate of 20% per year. The performance period for both the PSU and stock option long-term incentives are 3 years and 5-year vesting, 10-year term respectively.

Environmental, Social, Governance

Environmental

CNR is committed to reducing their footprint and decreasing total carbon emissions to help protect the environment. CNR consumes approximately 15% less fuel per gross ton mile of freight when compared to other Class I railroads, making CNR is the most fuel-efficient Class I railroad. Additionally, CNR has decreased locomotive emission intensity by 40% over the last 25 years. [29] CNR plans to continue efforts with long-term targets to reduce greenhouse gas emission intensity by 29% by 2030. To accomplish this, CNR plans to leverage innovative technologies, expand their renewable energy use, and enhance their train handling and operating practices. Recently, CNR has recorded a 4% improvement in locomotive fuel efficiency from 2019 to 2020 which translates to 275k tonnes of C02 emissions avoided, and $65M in savings.[30] Fuel efficient technologies that CNR has adopted include GE Transportation's GoLINC, which is an industrial data center platform that ultimately enhances communication and productivity within rail networks. CNR has equipped 260 of their locomotives with this technology to help improve efficiencies. Rail is also the one of the most fuel-efficient modes of transportation for long distances when compared to other methods. This is positive as in the long-term businesses, governments and consumers may turn to other methods to transport goods such as rail, that are ultimately more fuel-efficient and environmentally friendly compared to other methods such as trucking.

Social

CNR has focused on increasing safety within day-to-day operations by lowering injury frequency rate by 10% in 2020 compared to 2019. Additionally, they achieved 20% lower accident rate through by implementing technology such as their innovative automated inspection portals, and finally, 20% overall reduction in trespasser incidents. [31] CNR is focusing on improving safety within the workplace by creating robust employee training programs and adapting new technologies that allow for safer practices. Peer Canadian Pacific has had an industry leading safety rate for 13 years. [32] Additionally, CNR is taking steps to achieve greater diversity within their work force. They have developed a

[28] Canadian National Railway: 2021 Management Circular
[29] Canadian National Railway: Fuel Efficiency Page
[30] Canadian National Railway: 2020 Annual Report
[31] Canadian National Railway: 2020 Sustainability Report
[32] Canadian Pacific: 2018 Sustainability Report

diversity target which aims to attain a management team in which at least 30% of executives are woman by 2022. As the workforce continues to turnover due to retirements, CNR is hoping to increase their workforce's diversity at senior management levels. Compared to others, CNR is partially behind on their diversity efforts, however they are striving for improvement. For example, in 2018 CP had 45% of the board comprised of women and was the first Class I railroad in North America to appoint a woman as the chair of the board of directors.[33] Across the board, the industry is a male-dominant occupation however, CNR's efforts are increasing to expand its diversity.

Governance

Overall, we believe CNR naturally commits to sustainability and ESG practices within the industry and has made their efforts a priority. Ethical business decision making is rooted deeply in CNR's philosophy. CNR's aspirations are to develop and maintain over the long-term in a fair, and safe way while mutually benefitting suppliers, business partners and customers. [34] CNR's Code of Business Conduct lays out explicit details on supporting ethics and integrity through ensuring the right thing is always done to maintain a positive image in all aspects of the business, and encourage an innovative spirit among their employees while enhancing shareholder value.[35] Additionally, CNR also commits to uphold a human rights policy, safety policy, anti-corruption, harassment-free, employment equity, and various other policies to safely and responsibly govern the company and all stakeholders involved including the communities.

Financial Statement Analysis

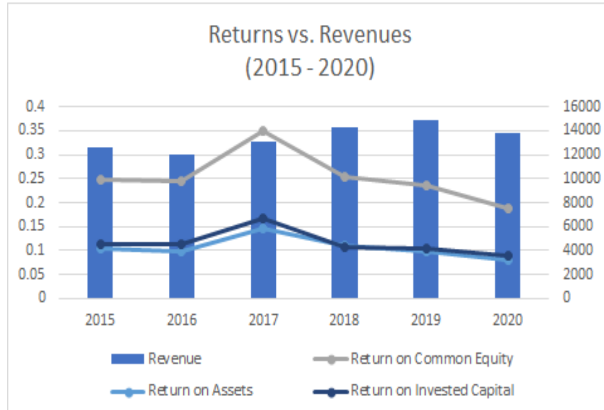
Canadian National Railway Co (CNR CN) - Ratios

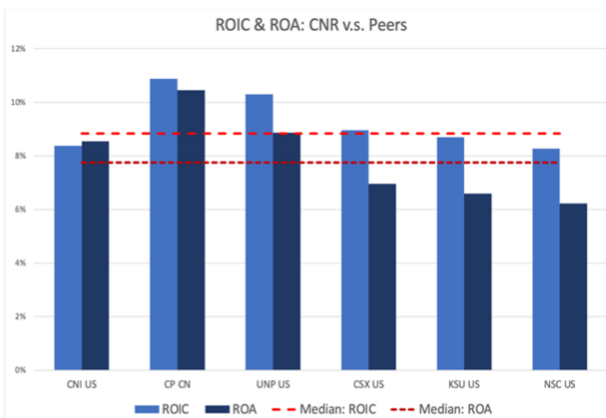
In Millions of CAD except Per Share 12 Months Ending	FY 2015 12/31/2015	FY 2016 12/31/2016	FY 2017 12/31/2017	FY 2018 12/31/2018	FY 2019 12/31/2019	FY 2020 12/31/2020
Returns						
Return on Common Equity	24.90%	24.44%	34.82%	25.24%	23.63%	18.90%
Return on Assets	10.39%	9.91%	14.69%	10.98%	9.92%	8.04%
Return on Invested Capital	11.30%	11.35%	16.70%	10.66%	10.56%	8.94%
Margins						
EBITDA Margin	50.94%	54.31%	52.44%	47.64%	49.11%	47.10%
Operating Margin	41.76%	44.13%	42.62%	38.36%	37.49%	34.57%
Net Income Margin	28.05%	30.24%	42.05%	30.22%	28.26%	25.78%
Additional						
Effective Tax Rate	27.41%	26.12%	-	23.83%	22.34%	21.61%
Dvd Payout Ratio	28.15%	31.84%	22.59%	30.80%	36.62%	45.93%
Liquidity						
Cash Ratio	0.05	0.06	0.02	0.08	0.01	0.17
Current Ratio	0.72	0.70	0.55	0.78	0.66	0.95
Quick Ratio	0.34	0.35	0.26	0.41	0.30	0.50
Solvency						
Long-Term Debt/Equity	60.10%	63.66%	52.52%	64.54%	67.87%	62.63%
Long-Term Debt/Capital	35.41%	36.65%	31.83%	37.69%	37.87%	37.32%
Long-Term Debt/Total Assets	24.68%	25.50%	23.25%	27.62%	27.97%	27.47%
Total Debt/Equity	69.75%	73.69%	65.01%	71.25%	79.25%	67.80%
Interest coverage	12.00	11.07	11.56	11.23	10.40	8.62
Activity						
Days Sales outstanding	26.14	26.65	26.02	27.44	29.14	30.02

[33] Canadian Pacific: 2018 Sustainability Report
[34] https://www.cn.ca/en/delivering-responsibly/governance/
[35] Canadian National Railway: Code of Business Conduct

Profitability: Returns and Margins

CNR's profitability has been relatively stagnant over the past six years and the recession triggered by the COVID-19 pandemic has had a role in exaggerating the lack of improvement in margins and returns. CNR had a very strong year in 2017 in terms of returns but has not been able to achieve those returns since then.

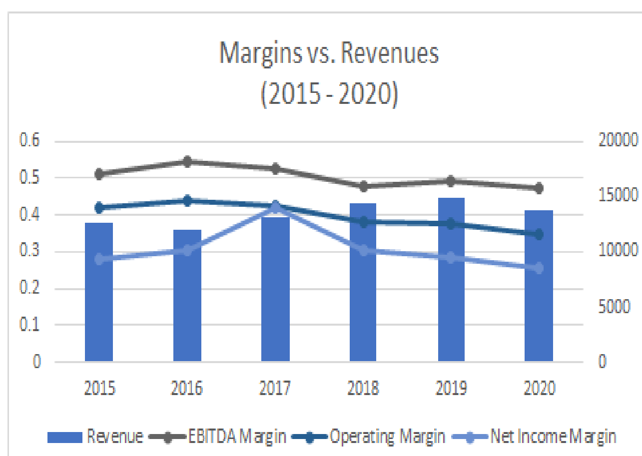




Compared to the industry, CNR has slightly above-average return on assets, but slightly lower than average return on invested capital.

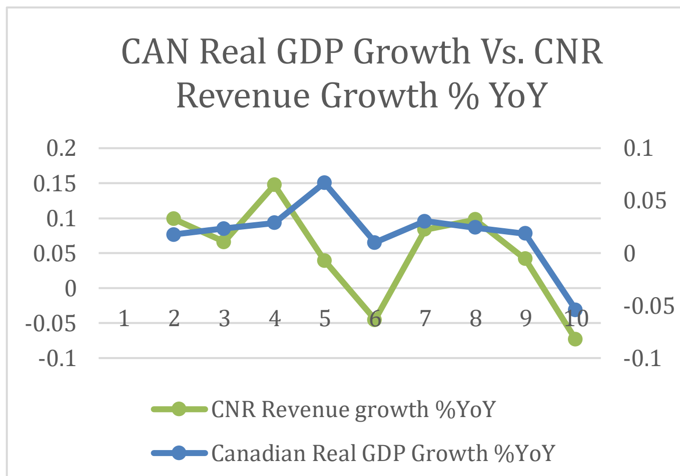
Margins have seen a slightly different trend over the past six years, but the slightly downward trajectory remains apparent here as well. We can also see by this chart net income spiking in 2017, which presumably also caused the spike in returns seen in the above chart in 2017. This sudden increase in net income was due to a deferred income tax recovery of $1,764 million resulting from the enactment of the U.S. Tax Reform, contributing to about 32% of the net income for that year.

CNR is aggressively investing in technology to make operations more automated and efficient. It will be several years before it becomes apparent whether these investments will ultimately lead to improvements in margin.



Growth

Total revenues have been growing at a CAGR of 4.53% over the past 10 years and appears to have slowed down over the last five, although some of the slowdown can be attributed to the impact that the COVID-19 pandemic and the incident lockdowns. This revenue growth is significantly above the industry average of about 3%. Management is looking at mid-single digit growth in volume for 2021. Long term revenue growth is likely to at least keep pace with nominal GDP growth in Canada and the U.S. As can be seen from the figure below, changes in the year-over-year percent changes in CNR's revenues roughly match those in Canada's real GDP, highlighting the cyclicality of the business. However, we also see that the average growth in CNR's revenues are significantly higher than average real GDP growth, showing that CNR has been able to both increase prices with inflation, as well as using inorganic growth to outpace the general economy.



CNR's growth has historically been driven by mergers and acquisitions, reflecting the consolidation in this industry. Recently, they acquired TransX, adding 1500 trucks, 4000 tractors, and 1000 intermodal containers to their network. CNR also acquired the intermodal division of Alberta-based H&R Transport. Both companies acquired have a significant amount of their business centered around temperature-controlled transportation, giving CNR a larger market share in the business of delivering perishable items such as meats. CNR is also working on closing an acquisition of the CSX Massena Line, which will give CNR access to a direct line between Montreal, QC, and Syracuse, NY. Most recently, CNR has challenged Canadian Pacific's move to acquire Kansas City Southern and made a more attractive bid to acquire the company. It is yet to be determined who will acquire the company, but if CNR were to acquire Kansas City Southern, this would represent a substantial expansion of their network. These acquisitions form an important part of expanding the reach of CNR's network and continue to build on the company's growth.

Dividends and share buybacks.

CNR has been paying regular dividends for well over two decades and have increased their dividends every year since 2005. Their payout ratio has historically been between 20% and 30%, but recently, the payout ratio has been increasing, with the most recent payout ratio being nearly 46%. Over the past three years, CNR's net income has been declining while dividends have been increasing, which explains why this payout ratio has increased. With capital expenditures being almost as large as net income each year—around 20% to 25% of revenues—this high dividend payout ratio is a cause for concern. However, if CNR can rebound and grow their earnings as the economy heads out of a recession and into an expansion, we should see the dividend payout ratio declining to levels that may be more sustainable. In addition, CNR has a very strong balance sheet, with low debt-to-equity and strong interest coverage, which gives them the ability to raise cash if needed.

CNR has engaged in share buybacks for as long as they have issued dividends. Over the five most recent years, CNR has only been buying back between 2 – 3% of shares outstanding per year, paying between 40 and 50% of net income. Share buybacks slowed significantly in 2020, making up only 9% of net income. Management aims to buy back 14 million shares in 2021, which is approximately 2% of the current shares outstanding.

Valuation

Discounted Cash Flow

The model's revenue growth can be attributed to increasing demand for CN's intermodal freight services, and steady grain, fertilizer, and forest product growth. The base case implies 6% growth for intermodal products in 2021 and 2022 which can be rationalized by trends in consumers increased demand for products. This rate slows down to 5.5% and then eventually 5% growth in 2023 and 2025 respectively. This assumption is almost in line with the average 5-year historical growth rate for intermodal freight revenues which is 5.47%. We also expect other freight categories CN transports in large quantities such as automotive products and coal to experience demand surges in late 2021 or early 2022 given an eventual return to a healthier and more normalized consumer and industrial spending environment. We also predict to experience short to medium term growth in the petroleum and chemicals category given the gradual economic recovery and cancellation of the Keystone XL pipeline which may present greater opportunities for CN to transport petroleum products via rail.

As for total revenue growth, typically, CN's revenue growth closely follows that of Canadian GDP with some residual difference. The base case implies we will see revenue grow between 6.22% and 3.85% between now and 2025. These assumptions may seem to be skewed towards the liberal side as CN has only experienced a CAGR of 2.08% in the past 5 years, however this figure includes the poor performance in 2020 due to the pandemic which resulted in an unexpected 7.36% cut to revenues. Eliminating 2020 from the equation, CN has experienced a revenue CAGR of 4.34% from 2014-2019 which is more in line with our 5-year CAGR prediction of 4.35%. This model has not priced in the effect of the recent bid to acquire Kansas City Southern.

The WACC used in the DCF model was calculated by using the levered beta of industry competitors and then unlevering the beta using the industry averages to finally lever it back up using CNR's current Debt/Equity ratio. We ultimately ended up with 3 calculated WACC's and took the average which was 6.39% which is slightly below the industry estimates of 7.3%. An EBITDA multiple of 15.5x was chosen as it roughly represents the industry mean of

15.3x which is above CN's current multiple of 14.1x. Conclusively, we arrived at an equity value of $110.26B and an implied share price of $154.92, representing a 14.04% upside as of market close on April 23, 2021.

FedEx Corporation - Discounted Cash Flow Valuation

Case Chosen	*Base*					
	2021E	**2022E**	**2023E**	**2024E**	**2025E**	**CV**
12 Months Ending	*12/31/2021*	*12/31/2022*	*12/31/2023*	*12/31/2024*	*12/31/2025*	
EBIT(1-Tax)	5,951	6,103	6,262	6,415	6,566	6,682
Depreciation	1,547	1,614	1,683	1,752	1,820	1,902
(Inc) Decrease In NWC	102	223	241	243	286	286
Less Cap Ex	3,000	3,354	3,486	3,540	3,591	3,845
Unlevered Free Cash Flow	**4,600**	**4,586**	**4,700**	**4,871**	**5,081**	**5,025**
Discount Period	*0.75*	*1.8*	*2.8*	*3.8*	*4.8*	*4.8*
PV of Free Cash Flows	**4,391**	**4,115**	**3,964**	**3,862**	**3,786**	**3,745**

Valuation Summary

Case	Base
WACC	6.39%
CV Growth Rate	2.0%
EBITDA Multiple	15.5x
Exit Multiple	
Terminal EBITDA	8,584.42
Terminal Value	$133,05
Discounted Terminal Value	$99,15
PV of Free Cash Flows	$23,86
Enterprise Value	**$123,01**
Cash	$56
(Debt)	$13,32
Equity Value	**$110,25**
Diluted Shares Outstanding	711.
Implied Price per Share	**$154.9**
Upside (Downside)	**14.04**

Sensativity Tables

Exit Multiple	*Dicount Rate* 5.50%	6.00%	6.50%	7.00%	7.50%	8.00%
12.5x	133.38061	130.29719	127.29406	124.36876	121.51889	118.74214
13.5x	142.73391	139.44277	136.23748	133.1154	130.07396	127.11071
14.5x	152.08721	148.58835	145.1809	141.86203	138.62904	135.47928
15.5x	161.44051	157.73393	154.12431	150.60867	147.18412	143.84785
16.5x	170.79381	166.87951	163.06773	159.35531	155.73919	152.21642
17.5x	180.14712	176.02509	172.01115	168.10195	164.29427	160.58499
18.5x	189.50042	185.17067	180.95456	176.84859	172.84935	168.95356

Relative Valuation

The peer group chosen for the relative valutation consists of the Canadian Pacific Railway, Union Pacfic, CSX Corporation, Kansas City Southern Railway, and Norfolk Southern Corporation. This peer group all compete in the same industry as CNR and provides a great representation of the North American Rail Industry. The Canadian Pacific Railway was chosen as they are CNR's only large Canadian competition. The U.S. rail competitors were chosen as CN's rail stretches down through the central Unitied States to the Gulf of Mexico. Also, there are multiple offers (one from CN and one from CP) to acquire Kansas City Rail and its inclusion in the relative valuation highlights the added competition CN might face should CP acquire KSU.

By using a weight of 25%, 25% and 50% for P/E, P/E Yr 2, and EV/EBITDA respectably we reach an implied share price of $144.80.

Canadian National Railway - Relative Valuation

Ticker	Name	P/E Current Yr	P/E Y2	EV/ EBITDA	Dividend Yield
None (6 securities)					
Median	Median	23.48	20.74	17.96	1.25%
CNI US Equity	CANADIAN NATIONAL RAILWAY CO	22.71	20.04	15.69	1.82%
CP CN Equity	CANADIAN PACIFIC RAILWAY LTD	22.78	20.59	18.64	0.82%
UNP US Equity	UNION PACIFIC CORP	23.62	20.88	17.1	1.72%
CSX US Equity	CSX CORP	23.34	20.5	16.16	1.10%
KSU US Equity	KANSAS CITY SOUTHERN	33.61	28.53	22.76	0.72%
NSC US Equity	NORFOLK SOUTHERN CORP	25.02	21.93	17.96	1.40%
	Median	23.48	20.735	17.53	1.25%
	Mean	25.18	22.08	18.05	1.26%
Implied Target Price		117.63	107.39	177.08	
		25%	25%	50%	
Average Implied Share Price		144.80			
Current Share Price		135.85			
Return		6.59%			

CNR Info	
Cash Per Share	30.80248
Debt Per Share	18.75827
EBITDA Per Share	9.41
Earnings Per Share Y1	5.01
Earnings per Share Y2	5.18

Investment Recommendation

Hold, Price Target $154.92

Investment Positives

Backbone of the Canadian Economy

For many years, many businesses and consumers have trusted Canadian National to efficiently deliver goods from origin to destination. Grain products, automotive, merchandise, petroleum, chemicals, and others quite simply are not worth much if they cannot be transported safely to the end user. The products in which Canadian National transports are considered needs which make CN's services a need. Canada will forever need efficient ways to transport goods cross-country, and CNR remains positioned well to meet such demand. With the rising concern in greenhouse gas emissions causing harm to our planet and rail being 75% more fuel efficient than trucking, we believe many including the government, businesses and consumers will increasingly remain reliant on rail to transport goods, further exemplifying CNR's dominant position, chugging the Canadian economy along the tracks.

Mature Business with High Barriers to Entry

Over the past century, Canadian National has developed a vast 20,000 route mile network servicing the greater Canadian population and had persisted to become the largest Class I railroad in Canada. CN's exclusive access to the port of Prince Rupert in BC, and route to Chicago which bypasses much of the congestion result from CN's past strategies and are two examples which demonstrate CN's advantage due to its maturity. The duopolistic competition between Canadian Pacific and Canadian National, along with high-cost barriers to entry reduce the number of competitors from entering the market, an advantage to the two players. Canadian National now benefits from economic growth which allows them to continue expanding its mature network, seeking to provide services to a greater customer base in more efficient ways.

Well Diversified Within Transportation Allowing for Prosperity Among Economic Turmoil

Canadian National's services mix including the transportation of forest products, petroleum and chemicals, grains and fertilizers, metals and minerals, coal, intermodal, and automotive products combine to create a well-diversified business model. Additionally in 2020, products such as grains and fertilizers which make up 19% of CN's revenue have outperformed 2019 revenues. Furthermore, forest product freight revenues only took a 6% cut in the 2020 turmoil, and intermodal product freight revenues, CN's largest source of freight revenue accounting for 26% of 2020 revenues took less than a 1% cut in 2020. This can be explained by the natures of the goods CN transports. For example, forest products such as lumber and panels are used in the process of building and renovating houses, which remained strong throughout 2020. Although Canadian National is dependent on a prosperous economy to supply services to growing customer bases, much of the commodities and products they service are considered essential and allow the company to continue performing well, even through economic troughs.

Merger with Kansas City Southern Could Drive Long-term Topline Growth

A successful merge with Kansas City Southern would likely provide Canadian National the opportunity to grow revenues over the long term by reaching new markets and populations. The gateway to Mexico would allow CN to offer customers a competitive cost-efficient way to transport goods to and from Mexico and would likely gain from the losses in the trucking industry. Long-term, we believe Canadian National would create a very efficient network linking Canada, US and Mexcio by leveraging automation and their PSR philosophy to offer customers compelling benefits in transitioning to intermodal transport.

Investment Negatives

Uncertainty Regarding the Kansas City Southern Merger

Following the Canadian Pacific and Canadian National bids to acquire Kansas City Southern, we are currently uncertain regarding who will end up with the company. Other Class I players like Union Pacific or Burlington Nothern Santa Fe may also place wagers which could further stir uncertainties, and cause one company to overpay for the asset.

Difficulty Improving Margins

Canadian National was one of the first to adopt a precision-scheduled railroading strategy as thus has experienced most margin improvement in the past. Although technology advancements and innovation will likely continue driving ratios lower in the long-run, peers such as Union Pacific will likely see greater margin improvement in the short-medium term as they adopt the PSR philosophy which may present a greater investment opportunity.

Catalyst for Recommendation Change

If the merge between Canadian National and Kansas City Southern materializes, it would be advisable to perform a revalution to determine the future impact as our model did not incorporate relatable growth factors. The merge could present revenue growth opportunities for CNR, particularity by offering customers friendlier cost-efficient solutions in shipping goods to and from Mexico. Additionally, ability to continue improving margins may also warrant a recommendation for change based on our current decision.

Overall, we feel that the positives of the investment outweigh the negatives, but due to the uncertainty currently surrounding the company, it is difficult to determine whether CNR's valuation makes it an attractive investment. Therefore, we are recommending a Hold at this time.

Disclaimer

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[i] Ownership of Major North American Rail Lines, 2017. (n.d.). Retrieved April 24, 2021, from https://transportgeography.org/contents/chapter5/rail-transportation-pipelines/rail-ownership-north-america/