Canadian National Railway (CNI)

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• I am not a registered investment advisor and I do not offer any investment advise

• No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments
Canadian National Railway - business

• Railway ;)

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Canadian National Railway- business (cont’d)
Canadian National Railway– Misc thoughts

• What can go wrong?
  • Less commodity transport?
• Recession – less transport
• Opportunities:
  • More commodity transport?
  • Lower cost than trucking (but is there any competition left?)
Strategic considerations

• Moat (*switching costs, habit, low cost*):
  • What are the moats? Infrastructure buildout
  • What does it take to sustain the moats? Pretty much super moat just stays unless something else is cheaper/more efficient (not going to happen)
  • Bargaining power of suppliers/customers? Large customers may have some power? Government controls?

• Is it a low risk business? Yes, but cyclical
• Is there high uncertainty? No, apart from cyclicity
• How capital intensive is the business? High
• Future growth – unknown
• Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Not clear
Management

• I don’t usually do management analysis. Included for template completeness
• No dilution
• Can I trust management?
• Management shareholding (> 10%)
• Management incentives?
• Are the salaries too high?
• Is there heavy insider buying?
• Is there heavy insider selling?
• Do I like the management? (Operators, capital allocators, integrity)
• Profitable reinvestment
• What has management done with the cash?
• Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV
Is it a good business?

• >10 year history of profits
• ROE:
  • 2008:17.9  2009:16.5  2010h1:17.90
• Margins
• Growing earnings: 3 year sales growth 0%, earnings growth -2%
• No dilution
• Somewhat weak balance sheet
  • Cash 900M, debt 7.5B
• ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets - non-debt liabilities - Cash)
  • 11% ROIC
Is it a good business? Cash flow

- Strong cash flow
  - H1 1456M operating cash flow, 1000M FCF (FCF = OCF - capital expenditures)
  - Operating cash flow higher than earnings
  - Free Cash Flow/Share higher than dividends paid
Is business cheap? - Buffettology calculations

- ROE 17% - assume 15%
- Earnings in 10 years = ROE*Equity*(1+ROE)⁹ = $6B
- Equity in 10 years = Equity*(1+ROE)⁹ = 41B
- Market cap = 6B x P/E (15) = $90B
- Rate of return = ~11% after tax (calculations omitted)

- 9 year earnings growth: 22%. Assuming same earnings growth for 10 years into the future and 15 PE at the end, shareprice would grow 20% annually. Assuming 15% earnings growth: 14% share price growth.
- Not very realistic to expect such growth either in equity or earnings
Is business cheap? DCF

• Discounted cash flow
  • Current earnings of ~2B
  • 10% growth for 5 years, leveling after that
    • 10% discount -> $30B current valuation (if you buy company at <$30B, you will get 10% return or higher)
    • 15% discount -> $19.44B current valuation
  • 5% growth for 10 years, leveling after that
    • 15% discount -> $17.9B current valuation
  • Owner’s yield = earnings / (market cap + debt - cash) = earnings/EV
    • 2B / (27.5B+7.5B-.9B) = 6.3%

• What makes up the margin of safety? Moat
• Is there a sufficient margin of safety? Not clear
Is business cheap? - Graham investment considerations

• N/A for CNI – included for completeness
• >2 P/Book – not a net net
• Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)