TRAIN2INVEST

Coaches Corner Bulletin
November 15, 2022

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& other instructions (verbal - implicit or explicit and any other form of communication) will not and cannot be constituted as a recommendation or advice for investment purposes.

FOR EDUCATION PURPOSES ONLY

November 11 Over Sold Positions:

TICKER	COMPANY	GLOBE	LAST	$CHG
IFC-T	Intact Financial Corp		193.74	-5.76
DOL-T	Dollarama Inc		77.34	-3.98
NTR-T	Nutrien Ltd		101.76	-3.74
WN-T	Weston George		151.92	-2.98
CNR-T	Canadian National Railway Co.		161.97	-2.39
CP-T	Canadian Pacific Railway Ltd		101.82	-2.19
L-T	Loblaw CO		109.78	-2.12

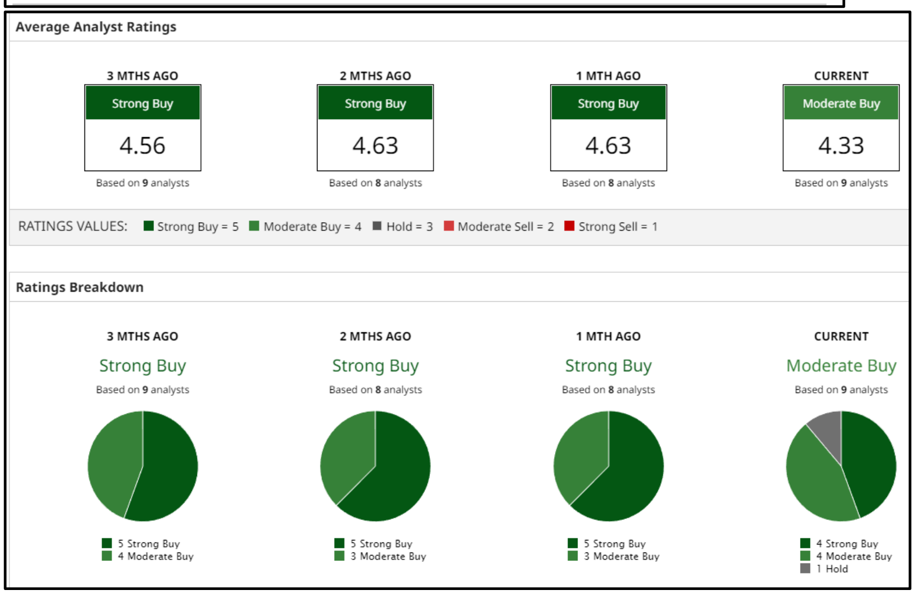
Things To Note:

- Do not be 100% invested, keep a cash reserve: If unsure, attend classes
- Look at the TSX trend, acquire on DOWN trend
- If capital is available to acquire 500 shares of XYZ, acquire 250 first – watch trend prior acquiring the additional 250 – you may get it at a better price, sometimes.
- Do not be dogmatic of selling at a specific price - $ 0.50 cents profit is still PROFIT.
- Don't let your imagination go wild, you are not going to be the next Elon musk!
- STOP whining – you are not a kid! Go with the trend. Don't go with the flow, only dead fish go with the flow
- Finally, no matter what, you are not investing in crypto or cannabis, so SMILE while you still have teeth!

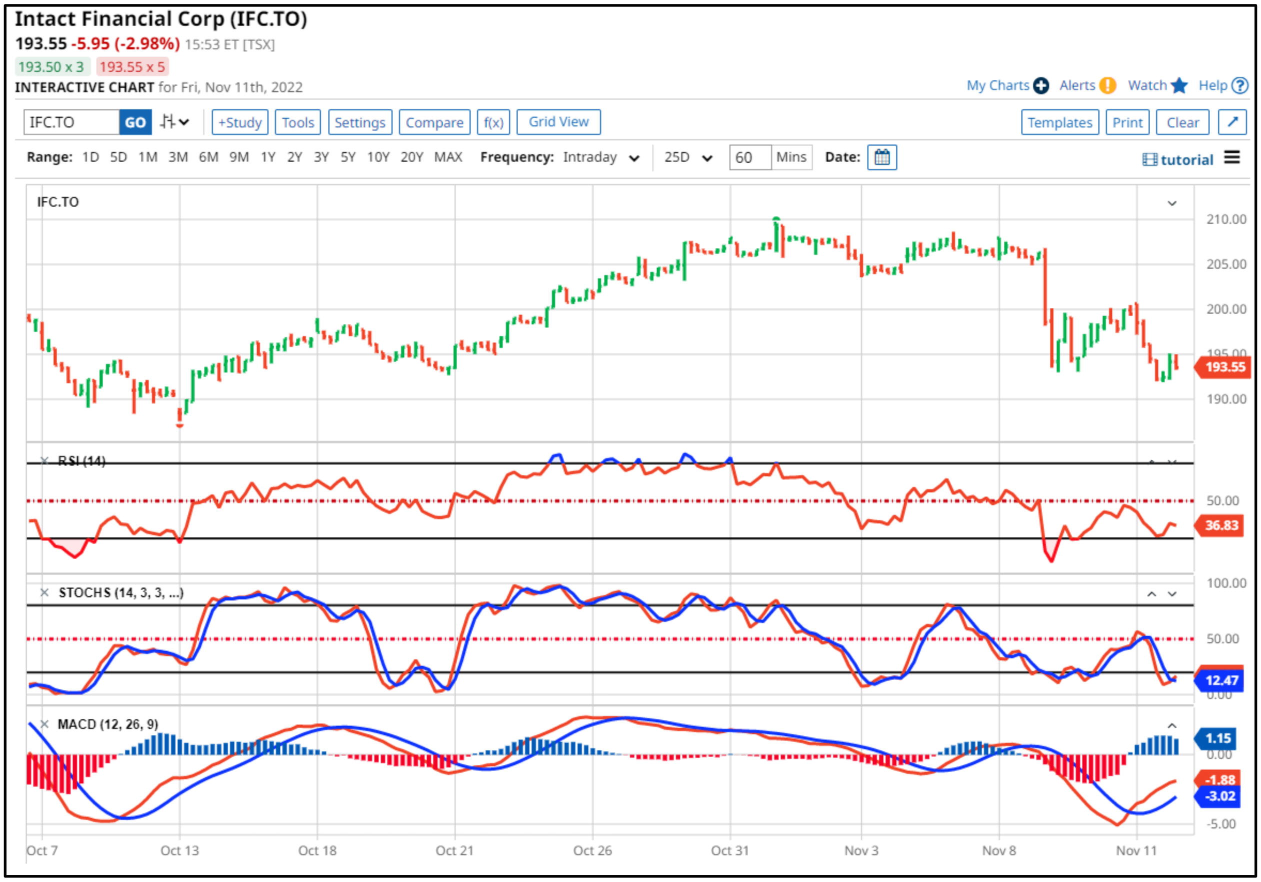
Intact Financial Corp (IFC.TO)

Intact Financial Corp is a property and casualty insurance company that provides written premiums in Canada. The company distributes insurance under the Intact Insurance brand through a network of brokers and a wholly-owned subsidiary, BrokerLink, and directly to consumers through Belairdirect. Most of the company's direct premiums are written in the personal automotive space. Intact directly manages its investments through subsidiary Intact Investment Management. The vast majority of these invested assets are fixed-income securities. Its asset mix is designed to generate interest and dividend income.

Next Earnings Date	11/08/22
Annual Dividend & Yield	4.00 (2.01%)
Most Recent Dividend	1.000 on 12/14/22



25D 60M

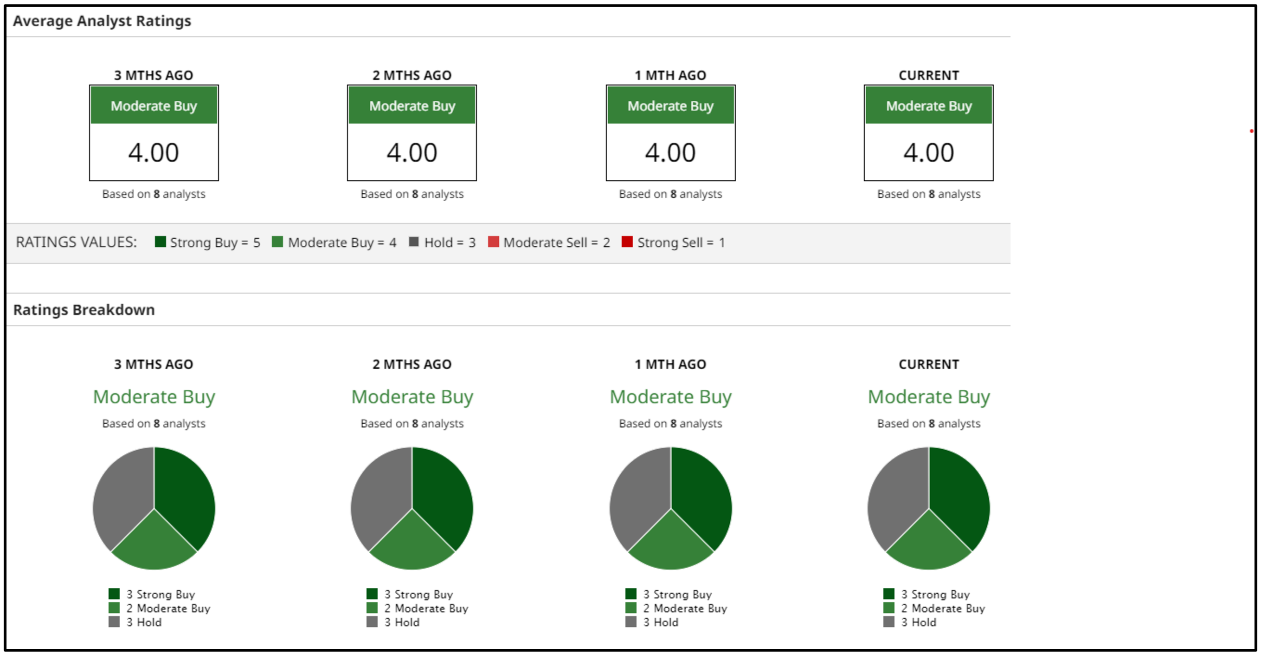


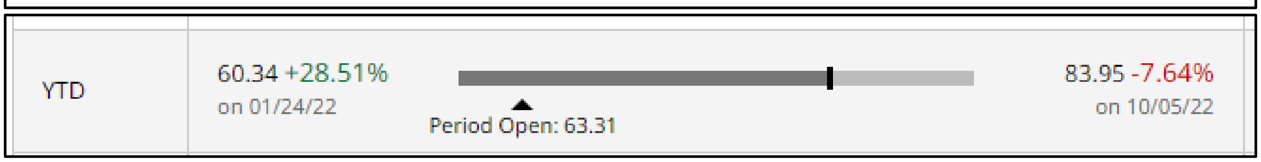
SUGGESTED STRATEGY:
Buy $ 193/$ 195
Sell: $ 200 / $ 205
Exit: $ 188

Dollarama Inc (DOL.TO)

Dollarama Inc is a Canada-based company principally engaged in operating discount retail stores. The company provides a broad range of everyday consumer products, general merchandise, and seasonal items, with merchandise at low fixed price points. General merchandise and consumer products jointly account for the majority of the company's product offerings. The company's stores are throughout Canada, generally located in convenient locations, such as metropolitan areas, midsize cities, and small towns. All the stores are owned and operated by the company.

Next Earnings Date	12/14/22
Annual Dividend & Yield	0.22 (0.27%)
Most Recent Dividend	0.055 on 10/06/22





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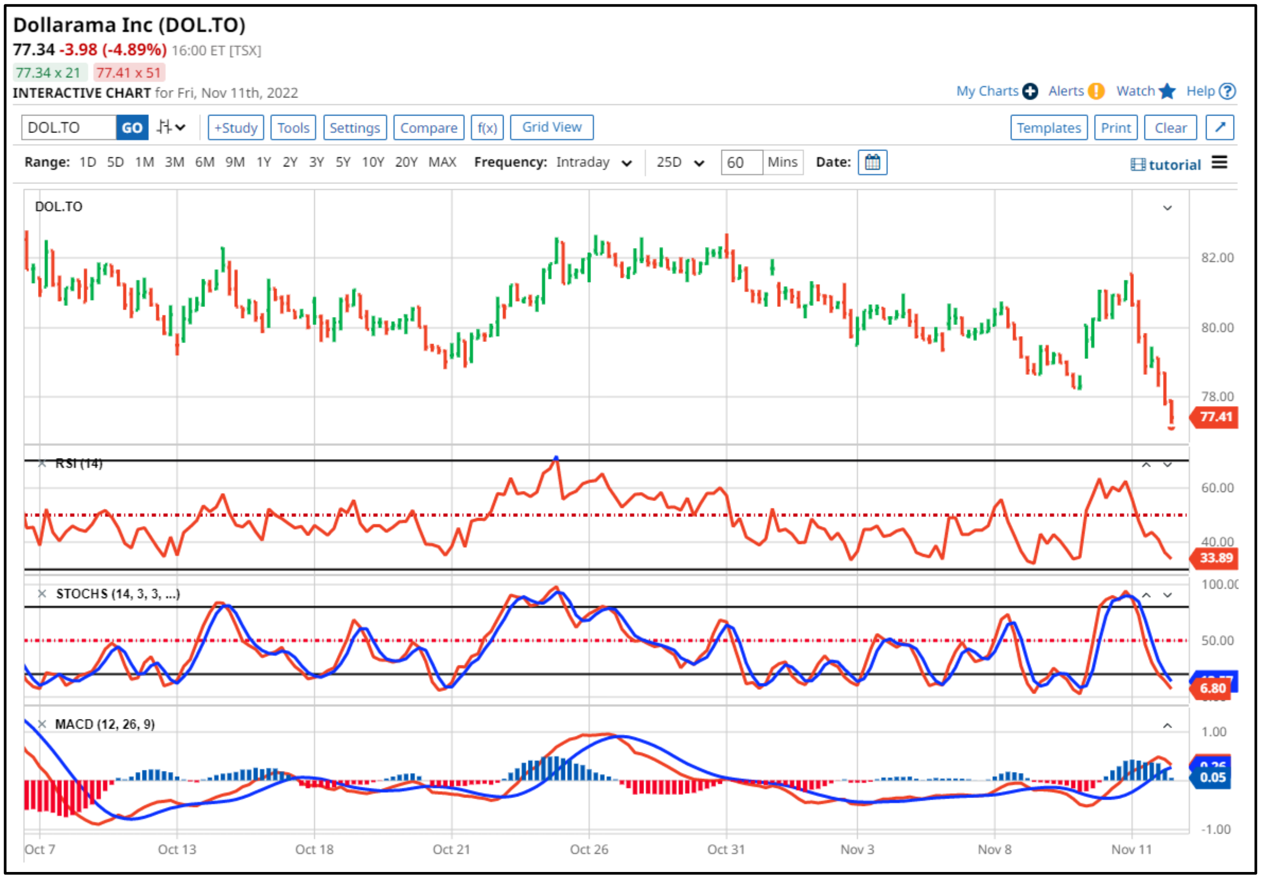


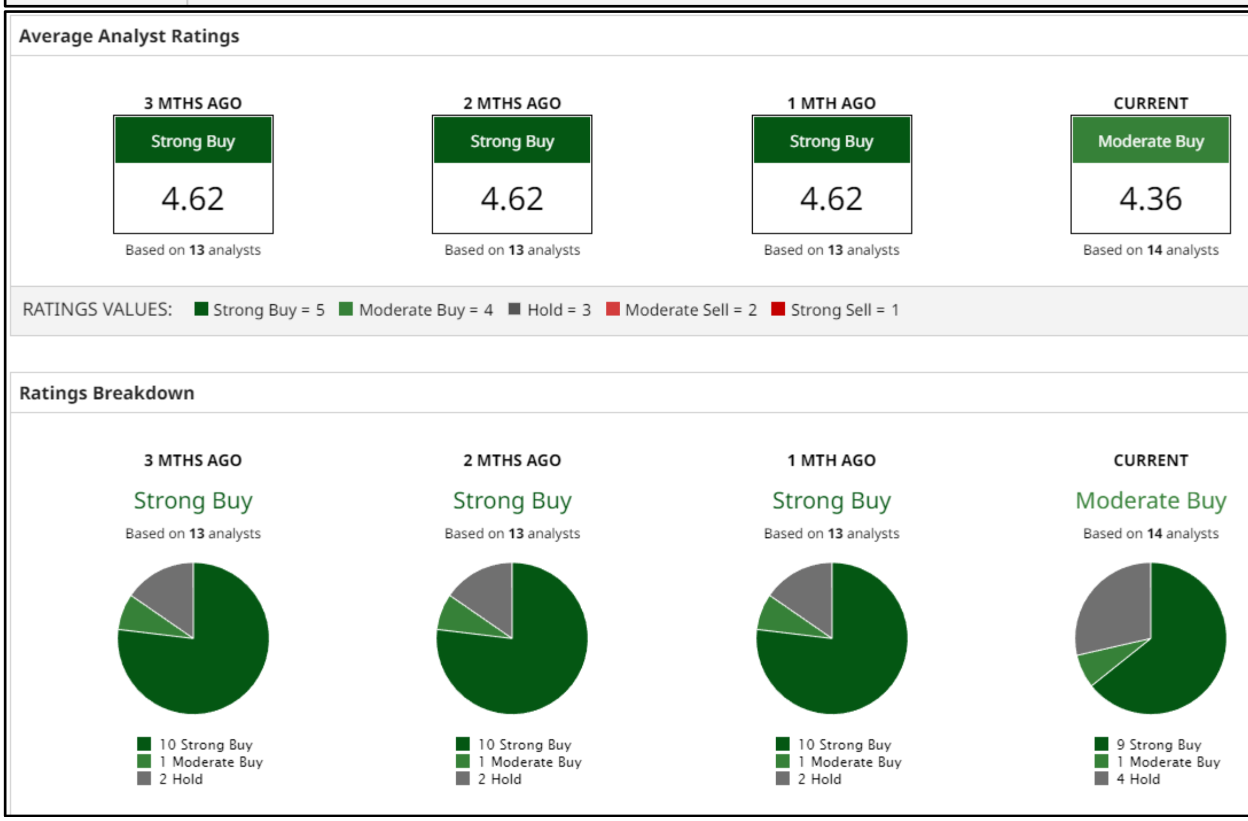
SUGGESTED STRATEGY:
Buy $ 76/$ 78
Sell: $ 80 / $ 82
Exit: $ 74

Nutrien Ltd (NTR.TO)

Created in 2018 as a result of the merger between PotashCorp and Agrium, Nutrien is the world's largest fertilizer producer by capacity. Nutrien produces the three main crop nutrients--nitrogen, potash, and phosphate--although its main focus is potash, where it is the global leader in installed capacity with roughly 20% share. The company is also the largest agricultural retailer in the United States, selling fertilizers, crop chemicals, seeds, and services directly to farm customers through its brick-and-mortar stores and online platforms.

Next Earnings Date	11/02/22
Annual Dividend & Yield	1.92 (2.48%)
Most Recent Dividend	0.480 on 12/29/22

YTD	85.28 +19.32% on 01/10/22	Period Open: 95.08	147.93 -31.21% on 04/18/22



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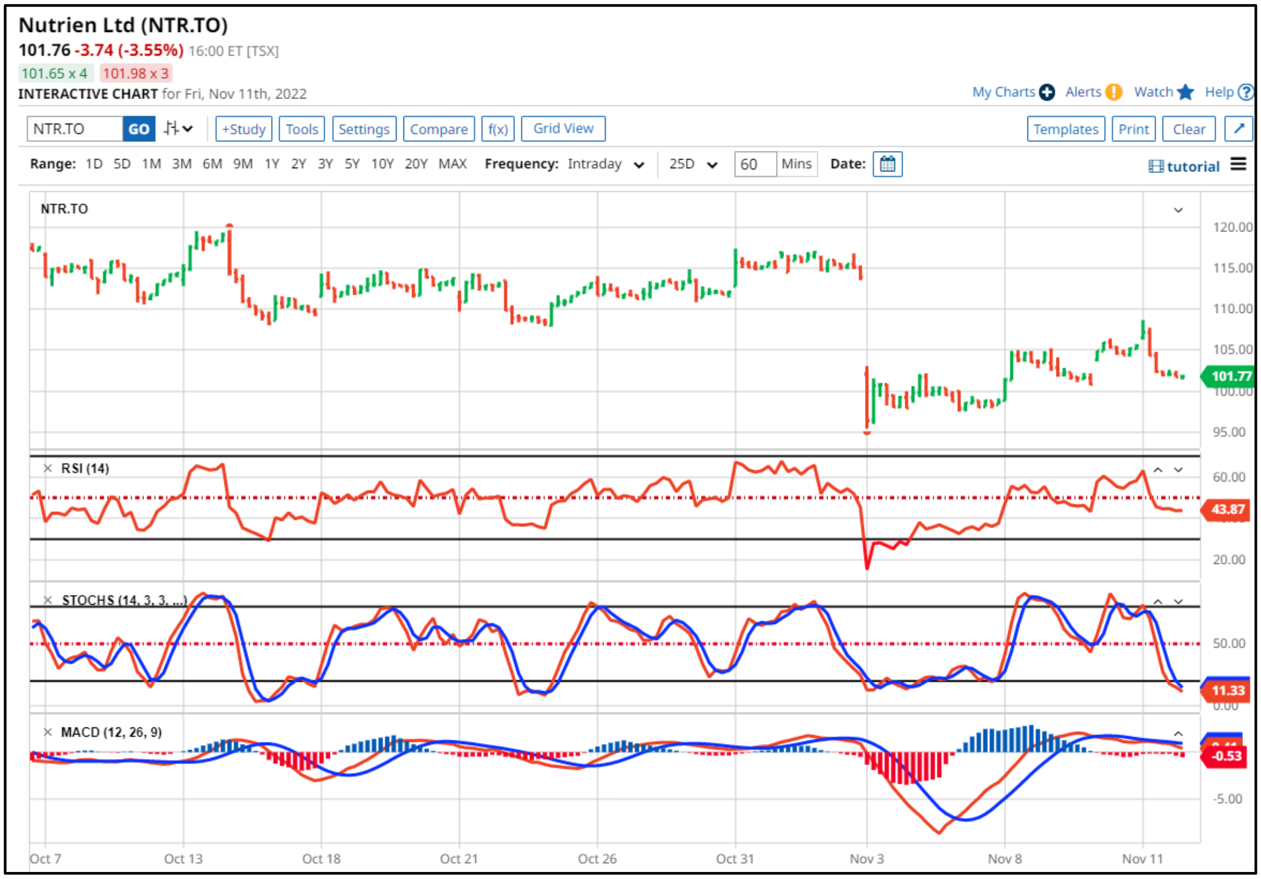


SUGGESTED STRATEGY:
Buy $ 100/$ 102
Sell: $ 105 / $ 107
Exit: $ 95

Weston George (WN.TO)

George Weston is a holding company that operates through two subsidiaries encompassing retail and real estate. The first is Loblaw, the largest grocer in Canada, in which it has a 53% controlling stake. The second is Choice Properties, an open-ended real estate investment trust, where George Weston's ownership sits close to 62%. The company sold Weston Foods, a North American bakery, in early 2022, which the firm had previously wholly owned. While the two remaining entities are separate, they operate under a contractual, as well as tacit, framework of strategic business partnerships. This is exemplified by Loblaw being Choice's largest tenant.

Next Earnings Date	11/22/22
Annual Dividend & Yield	2.64 (1.70%)
Most Recent Dividend	0.660 on 09/14/22

YTD	130.81 +16.14% on 01/24/22	Period Open: 146.66	162.51 -6.52% on 04/12/22

Average Analyst Ratings

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
Moderate Buy	Moderate Buy	Moderate Buy	Moderate Buy
4.00	4.00	3.67	3.67
Based on 2 analysts	Based on 2 analysts	Based on 3 analysts	Based on 3 analysts

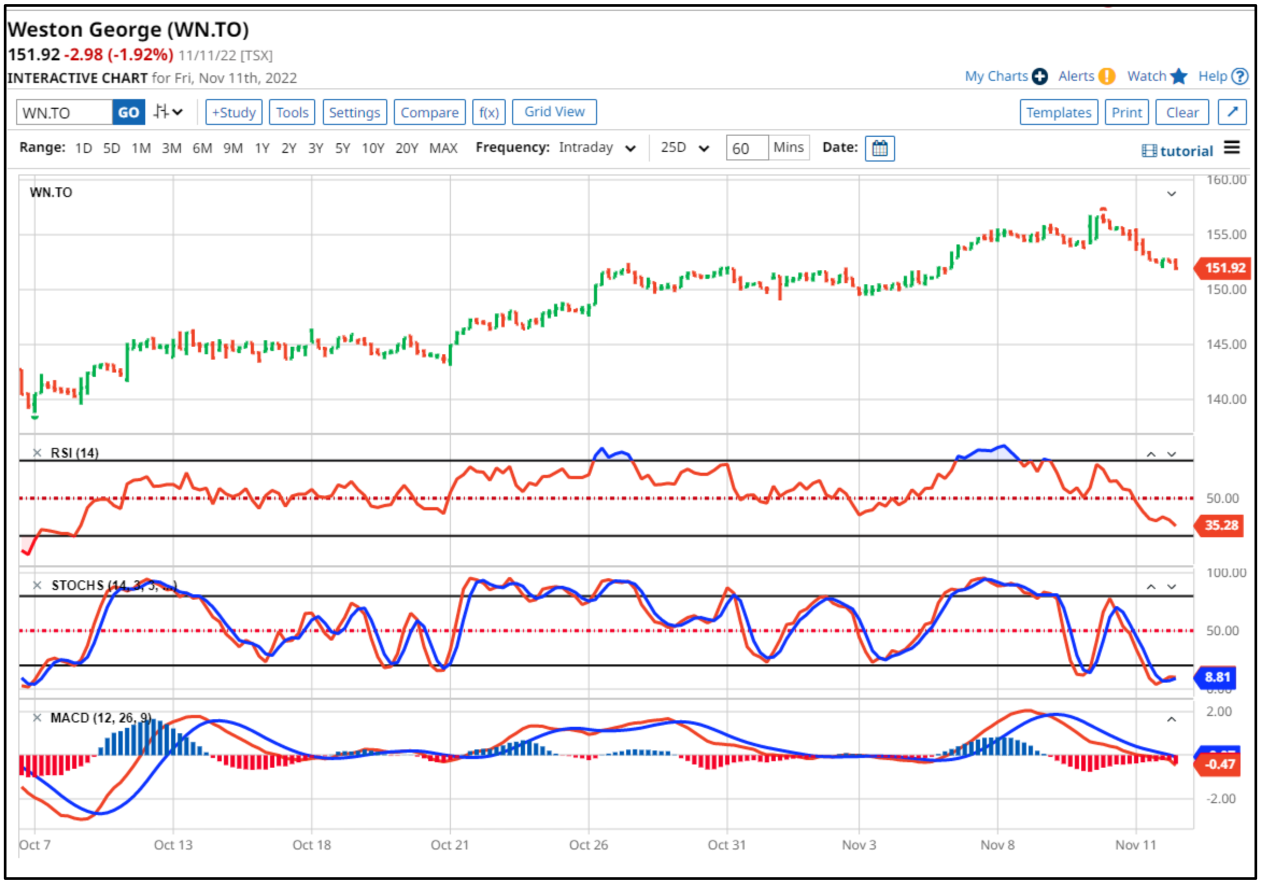
RATINGS VALUES: Strong Buy = 5 Moderate Buy = 4 Hold = 3 Moderate Sell = 2 Strong Sell = 1

Ratings Breakdown

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
Moderate Buy	Moderate Buy	Moderate Buy	Moderate Buy
Based on 2 analysts	Based on 2 analysts	Based on 3 analysts	Based on 3 analysts

2 Moderate Buy	2 Moderate Buy	2 Moderate Buy 1 Hold	2 Moderate Buy 1 Hold

25D 60M



SUGGESTED STRATEGY:
Buy $ 150
Sell: $ 153 / $ 155
Exit: $ 148

Canadian National Railway Co. (CNR.TO)

Canadian National's railway spans Canada from coast to coast and extends through Chicago to the Gulf of Mexico. In 2021, CN generated roughly CAD 14.5 billion in total revenue by hauling intermodal containers (25% of consolidated revenue), petroleum and chemicals (21%), grain and fertilizers (16%), forest products (12%), metals and mining (11%), automotive shipments (6%), and coal (4%). Other items constitute the remaining revenue.

Next Earnings Date	10/25/22
Annual Dividend & Yield	2.93 (1.78%)
Most Recent Dividend	0.733 on 12/07/22

YTD	137.26 +18.00% on 06/13/22	Period Open: 155.38	171.48 -5.55% on 03/29/22

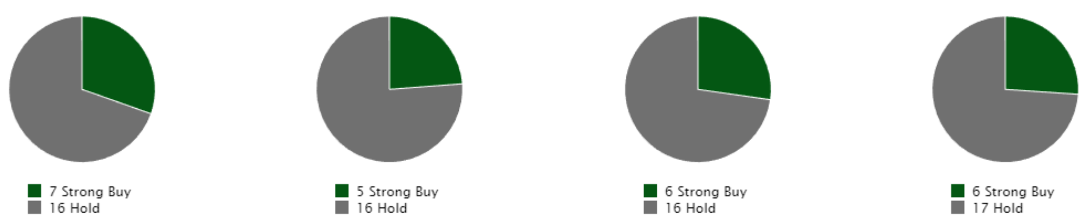
Average Analyst Ratings

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
Moderate Buy	Moderate Buy	Moderate Buy	Moderate Buy
3.61	3.48	3.55	3.52
Based on **23** analysts	Based on **21** analysts	Based on **22** analysts	Based on **23** analysts

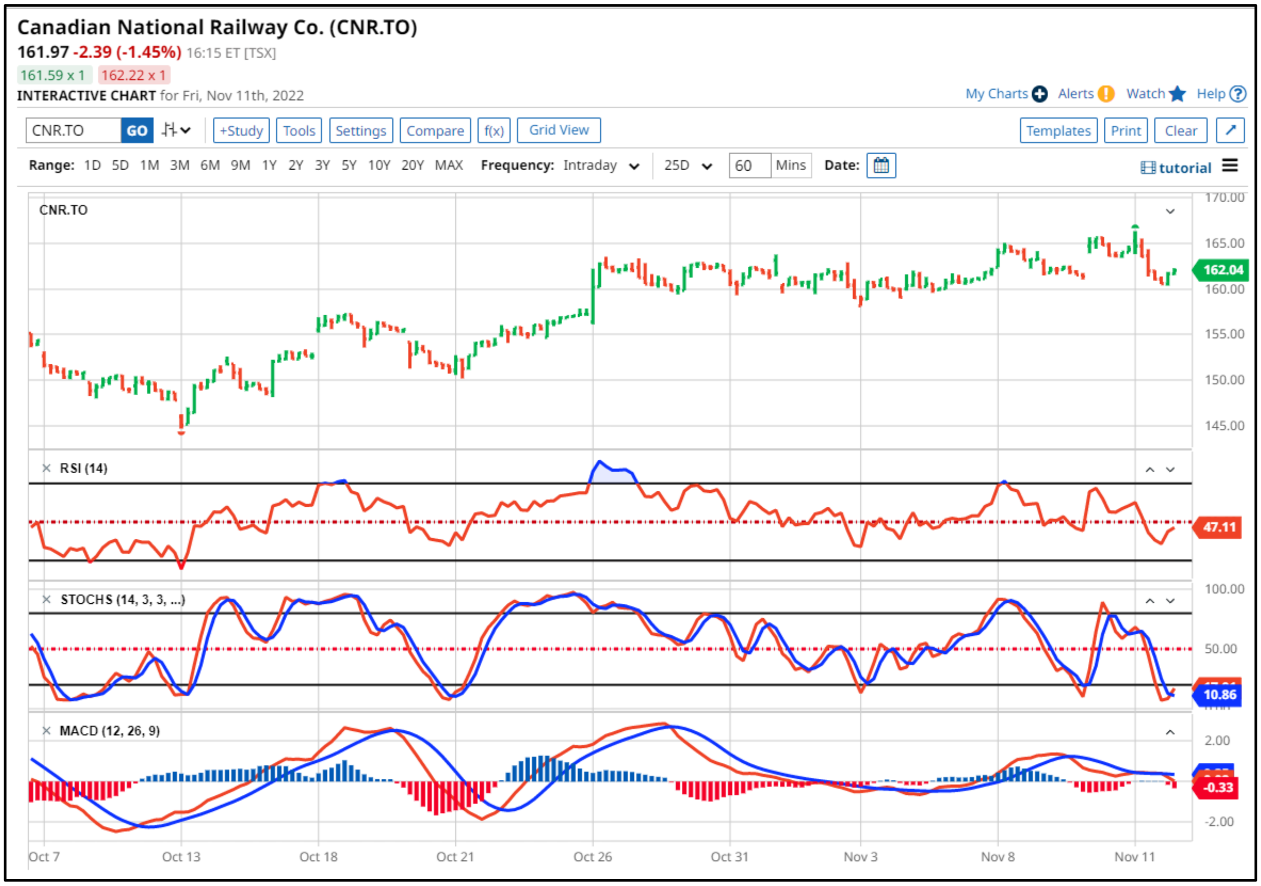
RATINGS VALUES: Strong Buy = 5 | Moderate Buy = 4 | Hold = 3 | Moderate Sell = 2 | Strong Sell = 1

Ratings Breakdown

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
Moderate Buy	Moderate Buy	Moderate Buy	Moderate Buy
Based on **23** analysts	Based on **21** analysts	Based on **22** analysts	Based on **23** analysts



25D 30M



SUGGESTED STRATEGY:
Buy $ 160/161
Sell: $ 163 / $ 165
Exit: $ 155

Canadian Pacific Railway Ltd (CP.TO)

Canadian Pacific is a CAD 8 billion Class-1 railroad operating on more than 12,500 miles of track across most of Canada and into parts of the Midwestern and Northeastern United States. It is the second-smallest Class I railroad by revenue and route miles. In 2021, CP hauled shipments of grain (22% of freight revenue), intermodal containers (22%), energy products (like crude and frac sand), chemicals, and plastics (20%), coal (8%), fertilizer and potash (10%), automotive products (5%), and a diverse mix of other merchandise.

Next Earnings Date	10/26/22
Annual Dividend & Yield	0.76 (0.73%)
Most Recent Dividend	0.190 on 12/29/22

52-Week	86.12 +18.23% on 02/24/22	Period Open: 96.80	106.93 -4.78% on 08/19/22

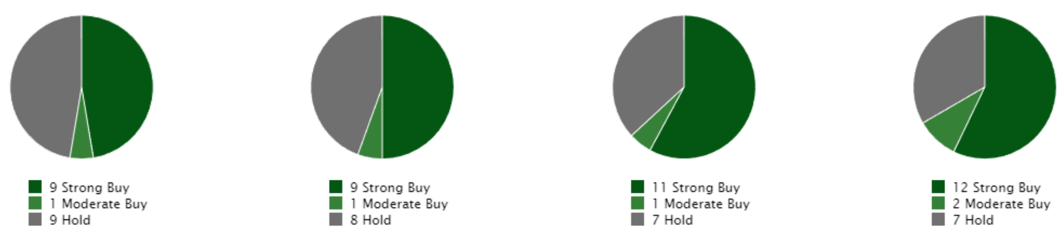
Average Analyst Ratings

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
Moderate Buy	Moderate Buy	Moderate Buy	Moderate Buy
4.00	4.06	4.21	4.24
Based on **19** analysts	Based on **18** analysts	Based on **19** analysts	Based on **21** analysts

RATINGS VALUES: Strong Buy = 5 Moderate Buy = 4 Hold = 3 Moderate Sell = 2 Strong Sell = 1

Ratings Breakdown

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
Moderate Buy	Moderate Buy	Moderate Buy	Moderate Buy
Based on **19** analysts	Based on **18** analysts	Based on **19** analysts	Based on **21** analysts



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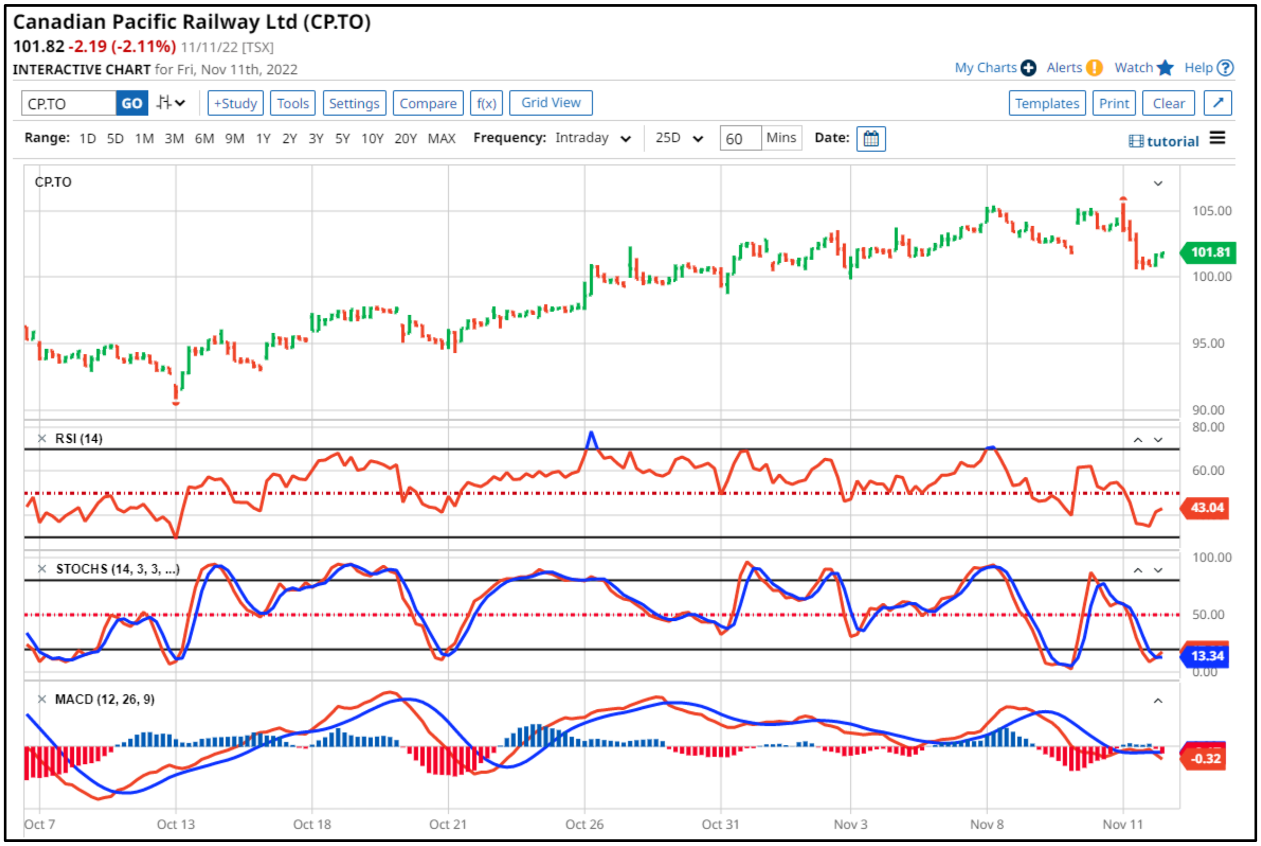


SUGGESTED STRATEGY:
Buy $ 100
Sell: $ 103 / $ 105
Exit: $ 95

Loblaw CO (L.TO)

Loblaw is one of Canada's largest grocery, pharmacy, and general merchandise retailers, operating the most expansive store footprint in Ontario and maintaining sizable presences in provinces like Quebec and British Columbia. Key grocery banners include Loblaw, No Frills, and Maxi, while its pharmaceutical operations are the product of its 2014 acquisition of Shoppers Drug Mart. The firm carries a robust private-label assortment, with top sellers like President's Choice and No Name. In addition to its retail operations, Loblaw oversees a financial-services business, which provides credit card services and guaranteed investment certificates, and also operates its PC Optimum loyalty program. The firm's controlling shareholder is **George Weston Limited,** which owns 52.6% of the equity.

Next Earnings Date	11/16/22
Annual Dividend & Yield	1.62 (1.45%)
Most Recent Dividend	0.405 on 09/14/22

YTD	90.46 +21.36% on 01/24/22	Period Open: 103.64	124.77 -12.01% on 08/17/22

Average Analyst Ratings

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
Moderate Buy	Moderate Buy	Moderate Buy	Moderate Buy
4.00	4.00	3.88	3.88
Based on 7 analysts	Based on 7 analysts	Based on 8 analysts	Based on 8 analysts

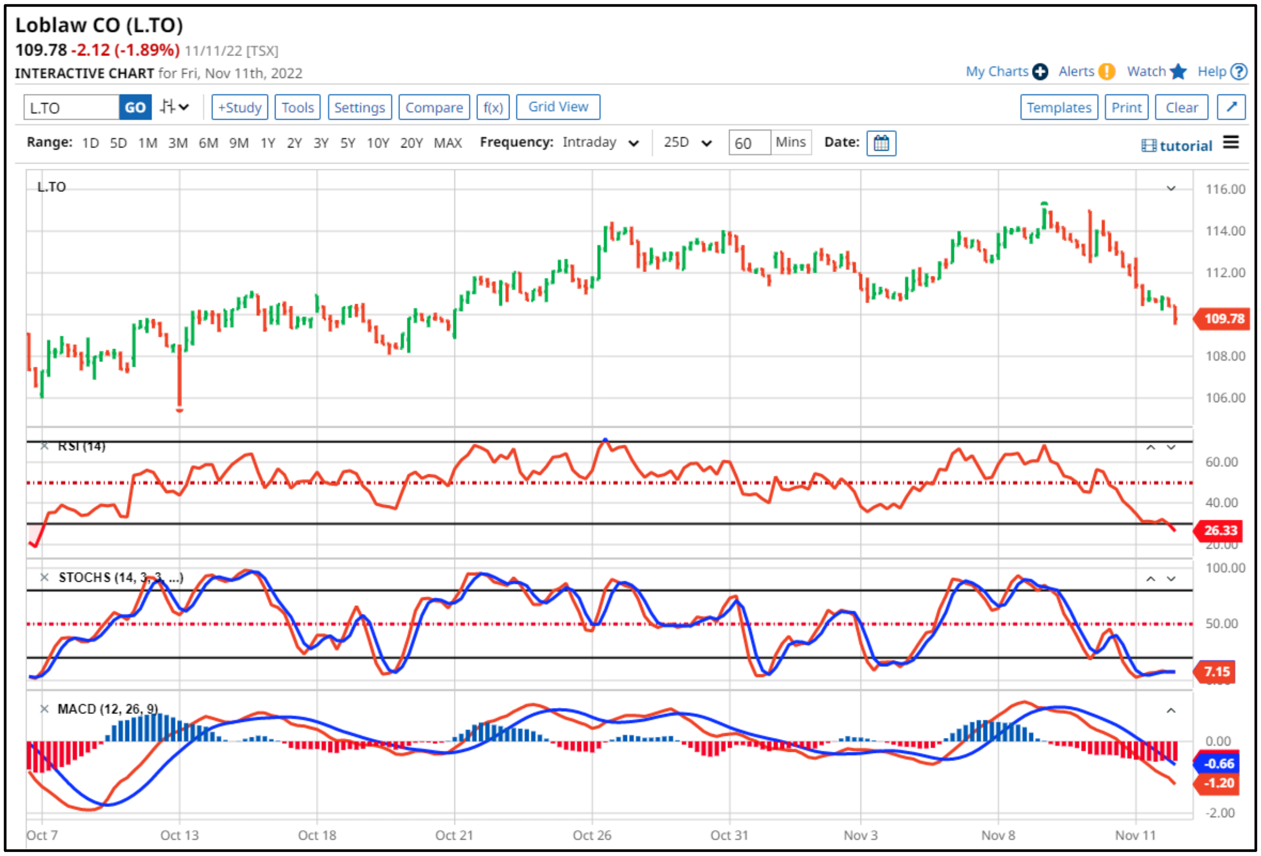
RATINGS VALUES: Strong Buy = 5 Moderate Buy = 4 Hold = 3 Moderate Sell = 2 Strong Sell = 1

Ratings Breakdown

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
Moderate Buy	Moderate Buy	Moderate Buy	Moderate Buy
Based on 7 analysts	Based on 7 analysts	Based on 8 analysts	Based on 8 analysts

3 MTHS AGO	2 MTHS AGO	1 MTH AGO	CURRENT
3 Strong Buy	3 Strong Buy	3 Strong Buy	3 Strong Buy
1 Moderate Buy	1 Moderate Buy	1 Moderate Buy	1 Moderate Buy
3 Hold	3 Hold	4 Hold	4 Hold

25D 30M



SUGGESTED STRATEGY:
Buy $ 109
Sell: $ 112 / $ 114
Exit: $ 106

The following information is given for broadening your knowledge – not added to fill the pages. Do the right thing – READ IT THROUGH!!!!

MORNINGSTAR ANALYSIS: Canadian Pacific Railway Ltd (CP)

Business Strategy and Outlook Updated Oct 31, 2022

Following the appointment of railroading legend Hunter Harrison as CEO in 2012, Canadian Pacific embarked on a profitability turnaround that proved successful. Initially upon taking the helm, Harrison closed numerous intermodal terminals and hump yards to right size the network. He also sold nonessential rail lines, turned over leadership, cut the workforce by 40%, cut locomotives, and returned thousands of leased cars.

Harrison and his successor—operations expert Keith Creel (who worked alongside Harrison for 20 years)—have taken CP from ranking as one of the worst Class I margin performers to among the best. We like that CEO Creel has further infused CP's culture with precision scheduled railroading principles, which stand behind the rail's progress. In 2018, CP's profitability caught up with PSR pioneer and historical margin leader Canadian National and surpassed CN in 2019 with a 60% operating ratio, or OR.

CP's freight mix is rich in bulk commodities such as grain, fertilizer, potash and metallurgical coal. Coal has historically made up a larger proportion of CP's portfolio than it does for peer CN due to CP's agreement with Teck Resources to haul cost-advantaged export coal. Intermodal is also a key business for CP, making up around 40% of carloads and more than 20% of revenue (primarily in Canada). Although CP's intermodal growth lagged that of CN at times over the past decade, PSR-related service enhancements have driven incremental opportunities and its growth profile has improved materially. As with the other Class I rails, we expect CP's strong competitive footing to support average core pricing at or above cost inflation over the long run, rising around 3%. Intermodal pricing will likely come in slightly lower due to exposure to truck competition.

In September 2021, Kansas City Southern accepted Canadian Pacific's outstanding merger offer as "superior," due to a greater chance of regulatory approval. As a result, KCS terminated its agreement with CN and accepted CP's offer. As a first step before regulatory review, CP acquired KCS in December 2021 and placed it into a voting trust, with no direct control during the STB review.

Economic Moat Updated Oct 31, 2022

In our view, each of the North American Class I railroads we cover, including Canadian Pacific, enjoys a wide economic moat rooted in cost advantages and efficient scale. Core pricing and margin resilience in past freight recessions and in the face of substantial coal volume losses over the past decade-plus are a testament to the rails' robust competitive positioning. With near certainty, we expect the rails to continue to leverage their two core moat sources into economic profit for the next 10 years and more likely than not 20 years from now.

Cost advantage is a key driver of CP's wide economic moat. While barges, ocean liners, aircraft, and trucks also haul freight, railroads are by far the low-cost option where no waterway connects the origin and destination, especially for freight with low value-per-unit weight (bulk commodities). Along those lines, railroads enjoy roughly quadruple the fuel efficiency of trucking (per ton-mile of freight), and through greater railcar capacity and train length, rails make more effective use of locomotive assets and manpower despite the need for train yard personnel. Rails can also carry significantly more freight at once. Even for freight that can be shipped by truck, we estimate railroads enjoy a 10%-30% discount on a similar lane (on average). Even for intermodal container freight, which is largely made up of consumer-related products, rail has historically been cheaper than its key competitor truckload shipping on average over the cycle thanks to the rails' aforementioned fuel efficiency and more economical use of labor.

Furthermore, route density plays a role in rails' cost advantage relative to a would-be new railroad entrant in a given corridor. We don't expect any new mainlines to be built in the future, but the incumbent Class I providers would enjoy vastly lower unit and marginal costs than an upstart given immense network/lane density—the existing seven North American Class I railroads have thousands of customers across myriad end markets and geographies that drive significant freight volumes across their networks.

In addition to cost advantage, CP and its peers benefit from efficient scale. Would-be rational competitors have little incentive to enter because massive up-front infrastructure costs and the potential for creating excess capacity amid limited demand would preclude economic profit and destroy value. The network of track and assets that the North American Class I railroads have in place is essentially impossible to replicate. CP's network spans Canada from east to west. It doesn't reach as deeply into the U.S. as peer Canadian National, but CP's operations do touch portions of the Midwestern and Eastern U.S. Railroads occasionally build new spurs and restore abandoned lines, but we anticipate no new mainlines will be built, given massive entry barriers.

Efficient scale followed industry consolidation escalated by the 1980 Staggers Act, which permitted extensive rail line sales, abandonment, and combination while allowing for private contracts and rate setting based on market demand. In 1980, more than 40 Class I rails operated across North America, and today there are only seven; by definition, a Class I rail generates at least $475 million of revenue. Consequently, on all but the busiest lanes, a single railroad often serves an end-of-the-line shipper, only two railroads operate in most regions, and the rails have been able to reinvest while becoming quite profitable. In fact, we suspect that absent government intervention, the rational number of competitors on the continent would be two, via additional consolidation. This is because in most regions customers already have only two capable providers that service the market effectively and efficiently.

Fair Value and Profit Drivers Updated Oct 31, 2022

Our fair value estimate is USD 66 per share. Our USD fair value estimate is translated via CAD 1.35 per USD. Note that KSU is not consolidated into CP's financials while in voting trust (during the STB review process). CP is accounting for KSU's results via the equity method. In our model, KSU equity income reflects our forecasts for KSU's net income, incremental deal amortization (offset by tax credits), and anticipated deal synergies.

In 2021, organic revenue grew 7% on industrial sector recovery off pandemic lows, an uptick in coal, and as retailer restocking and tight trucking-market capacity drove up demand for intermodal containers. Pricing was especially favorable, with core rates up strongly, contributing to a 6% yield increase. 2021 wasn't without its challenges as the semiconductor shortage hit auto activity, port disruption weighed on international-intermodal in the second half, and second-half carloads faced disruption from wildfires and severe flooding. CP's adjusted operating ratio (expenses/revenue) worsened 60 basis points to 57.6% in 2021 due to network disruption, rising cost inflation, and fuel surcharge lag, but this was still an excellent showing and it ranked among the best.

For 2022, we look for CP's top line to expand 19% on solid core pricing gains, much higher fuel surcharges, and low-single-digit total volume growth. Volumes declined around 6% year over year in the first half due in part to labor-related network service headwinds, but we expect double-digit growth on average in the back half on strength in potash, recovering grain and auto carloads, and better network fluidity (hiring progress). We note the late 2022 Canadian grain harvest is turning out to be far better than last year—a key driver of carload volume recovery in late 2022 through early 2023.

While underlying demand and pricing gains remained positive through third-quarter 2022, we expect deterioration in CP's full year 2022 adjusted operating ratio (to roughly 61%) due to fuel surcharge lag, wage inflation, and lost volume related leverage in the first half (including severe cold-weather disruption early in the year). That said, we expect sequential OR improvement in fourth-quarter 2022 into the 56% range, with help from volume growth.

On a stand-alone basis in 2023 (excluding Kansas City Southern's operations held in trust until STB approval), we look for CP's revenue to grow 1%-3%. In our view, demand risk is elevated given inflation's threat to industrial and retail end markets. However, we currently model 1%-3% total volume growth in 2023 on continued tailwinds for grain, potash, and automotive shipments, including new wins on the project development front, partly offset by a softer macroeconomic backdrop. We suspect core contract pricing will remain positive next year, but we bake in flattish overall total yield on potentially lower fuel surcharges, normalizing accessorial income, and lower intermodal pricing due to heightened competition from easing contract rates in the trucking sector. On the margin front, we look for OR improvement to 57%-57.5% in 2023 and 55.5%-56% in 2024.

Longer term, we believe CP's pricing power will prove sound (above rail inflation), as will its ability to neutralize diesel price shocks via surcharges. We assume a midcycle operating ratio near 55.5%. Longer term, we expect CP to invest 17%-19% of sales in capital expenditures to maintain and improve network operations—below the historical average thanks to previous asset utilization gains.

Risk and Uncertainty Updated Oct 31, 2022

Our Uncertainty Rating for Canadian Pacific is Medium. CP is exposed to the health of the North American economy and to a lesser degree China (partly from potash exports to the region). Intermodal demand is influenced by goods consumption and retailer restocking. Additionally, CP's pending merger with Kansas City Southern carries integration risk and the threat of overpayment should expected EBITDA synergies fall short (estimated at USD 1 billion within three years of consolidation)—CP paid KCS a substantial premium, in our view.

Given the northern location of CP's assets, winter weather can materially hamper efficiency by blocking tracks and necessitating shorter trains. We note that diesel price shocks are largely mitigated via fuel surcharges.

In terms of environmental, social, and governance risks, because CP carries freight for chemical and energy end-market shippers, it is subject to the liabilities associated with hazardous material spills. Furthermore, the U.S. Surface Transportation Board oversees railroads' pricing, thus there will always be underlying risk of reregulation for some of CP's U.S. operations. That said, although there have been discussions of reform over the years (including comments during 2021 from the Biden administration), reregulation isn't a foregone conclusion if cooler heads prevail. The STB's long-standing market-based approach has provided a balanced regulatory framework yielding a relatively small number of annual rate cases and reasonable outcomes that are often settled.

Variability in natural gas prices and intensifying environmental regulations put CP's utility coal shipments at risk of disappearing over the long run. However, if coal must be hauled, rail is the fuel-efficient lower-emission option compared with trucking.

Kansas City Southern and its U.S. peers are currently renegotiating contracts with their key labor unions, raising the risk of greater-than-expected wage inflation or (less likely) work stoppages in 2022.

Capital Allocation Updated Oct 31, 2022

We award Canadian Pacific a Standard capital allocation rating, which reflects our assessment that the company's balance sheet is sound and the quality of its investing is fair and reasonable, and supports its strong competitive positioning. We think shareholder distributions are appropriate.

Following a successful proxy fight by hedge fund Pershing Square Capital, Canadian Pacific appointed precision railroading pioneer Hunter Harrison as president and CEO in June 2012. This move launched CP's impressive turnaround. Installing former Canadian National CEO Harrison to lead was a primary objective in Pershing Square's push for new leadership. Harrison was a key driver of CN's industry leading margin profile, and his work at CP followed suit as he sparked dramatic operational improvement—CP's adjusted operating ratio (expenses/revenue) averaged 79% between 2008 and 2012, but progressed to around 61% when Harrison departed in 2017.

In early 2013, CP brought on board former CN COO Keith Creel as its own COO, and upon Harrison's departure to CSX in early 2017, Creel took the reins as CEO. This was a prudent choice, in our view. Who better to continue Harrison's operating plan than the COO he groomed for the role at another railroad? Creel is a veteran railroader who began as an operating management trainee at BNSF in 1992. Creel's performance at CP has proved solid, as the rail's operating ratio (lower is better) caught up with top-shelf CN in 2018, hit the 60% mark in 2019, and improved further to 57.1% in 2020.

The firm appointed Nadeem Velani as CFO in October 2016, following the surprisingly short tenure of two prior CFOs over the previous three years. Velani was in Harrison's inner circle for years and is thus well versed in PSR, which has been at the core of CP's margin progress.

CP paid a meaningful premium to acquire Kansas City Southern, which adds risk to our capital allocation assessment if synergies don't pan out as expected. That said, CP is an incredibly well-run railroad with a highly talented leadership team and an excellent track record in terms of efficiency improvement over the past decade, thus we consider deal risk to be relatively modest. We also agree that the merger makes sense from a strategic perspective and believe the combined railroads will forge meaningful opportunities on the revenue front, thanks to adding new seamless single-line services.

MORNINGSTAR ANALYSIS: Canadian National Railway Co (CNR)

Business Strategy and Outlook

Updated Oct 31, 2022

While peers have caught up over the years, especially Canadian Pacific, Canadian National was long the highest-margin (lowest operating ratio) Class I railroad due in large part to being the precision railroading pioneer in the 2000s. Recall that PSR architect Hunter Harrison left CN in 2009 and subsequently ended up applying his playbook at CP. Historically speaking, CN bolstered its velocity by making greater use of distributed-power locomotives and extending sidings at port staging areas. Running a scheduled railroad requires commitment to on-time train departures from both employees and customers queuing cars for departure. We think PSR is still in CN's DNA, though over the past few years, we sense management was focused more on growth than margins (albeit growth has been tempered in recent years by external events like congestion, strikes, blockages, tough weather, and so forth).

Railroads generate solid cash, and CN is no exception with free cash flow in the high-teens as a percentage of sales on average over the past decade. CN's mix is richest in intermodal, agriculture, and chemicals, though forest products and autos contribute meaningfully to results. Although CN recently won a few contracts on the coal front, the rail has historically had limited reliance on coal (5% of volume in 2020; 6.5% in 2021).

A railroad's competitive advantages are inseparable from its geography, and CN's network boasts a unique three-coast system spanning Canada coast to coast, and down through the U.S. to New Orleans. CN's EJ&E line around Chicago has boosted its velocity at a major choke point over the years, benefiting network reliability and asset turns. Also, CN enjoys exclusive access to Canada's port of Prince Rupert, which has contributed to its intermodal franchise growth prospects. We suspect CN is less exposed to U.S. regulatory risk than the U.S. Class I rails because on its U.S. route, the option to ship by barge on the Mississippi River makes CN's customers less captive than those of inland rails.

Economic Moat Updated Oct 31, 2022

In our view, each of the North American Class I railroads we cover, including Union Pacific, enjoys a wide economic moat rooted in cost advantages and efficient scale. Core pricing and margin resilience in past freight recessions and in the face of substantial coal volume losses over the past decade-plus are a testament to the rails' robust competitive positioning. With near certainty, we expect the rails to continue to leverage their two core moat sources into economic profit for the next 10 years and more likely than not 20 years from now.

Cost advantage is a key driver of CN's wide economic moat. While barges, ocean liners, aircraft, and trucks also haul freight, railroads are by far the low-cost option where no waterway connects the origin and destination, especially for freight with low value-per-unit weight (bulk commodities). Along those lines, railroads enjoy roughly quadruple the fuel efficiency of trucking (per ton-mile of freight), and through greater railcar capacity and train length, rails make more effective use of locomotive assets and manpower despite the need for train yard personnel. Rails can also carry significantly more freight at once. Even for freight that can be shipped by truck, we estimate railroads enjoy a 10%-30% discount on a similar lane (on average). Even for intermodal container freight, which is largely made up of consumer-related products, rail has historically been cheaper than its key competitor truckload shipping on average over the cycle thanks to the rails' aforementioned fuel efficiency and more economical use of labor.

Furthermore, route density plays a role in rails' cost advantage relative to a would-be new railroad entrant in a given corridor. We don't expect any new mainlines to be built in the future, but the incumbent Class I providers would enjoy vastly lower unit and marginal costs than an upstart given immense network/lane density—the existing seven North American Class I railroads have thousands of customers across myriad end markets and geographies that drive significant freight volumes across their networks.

In addition to cost advantage, CN and its Class I peers benefit from efficient scale. That is, would-be rational competitors have little incentive to enter because massive upfront infrastructure costs and the potential for creating excess capacity amid limited demand would preclude economic profit and destroy value. The network of track and assets that the North American Class I railroads have in place is essentially impossible to replicate. CN's system is a unique three-coast, Y-shaped network, spanning Canada from east to west and stretching from north to south in the Midwestern United States. CN's rights of way and installed track across the full width of Canada and top to bottom of the U.S. form a nearly impenetrable barrier to entry. Railroads occasionally build new spurs and restore abandoned lines, but we anticipate no new mainlines will be built given massive entry barriers.

Efficient scale followed industry consolidation escalated by the 1980 Staggers Act, which permitted extensive rail line sales, abandonment, and combination while allowing for private contracts and rate setting based on market demand. In 1980, more than 40 Class I rails operated across North America, and today there are only seven; by definition, a Class I rail generates at least $475 million of revenue. Consequently, on all but the busiest lanes, a single railroad often serves an end-of-the-line shipper, only two railroads operate in most regions, and the rails have been able to reinvest while becoming quite profitable. In fact, we suspect that absent government intervention the rational number of competitors on the continent would be two, via additional consolidation. This is because in most regions customers already have only two capable providers that service the market effectively and efficiently.

Fair Value and Profit Drivers

Updated Oct 31, 2022

We are raising our DCF-derived fair value for Canadian National slightly to CAD 145 per share, from CAD 143 due to the time value of money since our last update.

In 2021, CN's organic revenue grew 9% on industrial sector recovery off pandemic lows, a new contract with Teck Resources, and as retailer restocking and tight trucking-market capacity drove up demand for intermodal containers. Pricing was especially favorable (and the key growth driver), with core rates up a historically strong 5%. However, 2021 wasn't without its challenges as the semiconductor shortage hit auto activity, port disruption weighed on international-intermodal in the second half, and fourth-quarter carloads faced flooding in British Columbia.

Despite network disruption, CN’s adjusted operating ratio (expenses/revenue) improved 350 basis points in 2021, to 57.9%. on leverage from strong yields and lower average headcount, though the operating ratio continued to lag CN's peers in 2021.

For 2022, we look for CN's top line to expand 17% on solid core pricing gains, much higher fuel surcharges, and low-single-digit total volume growth. Volumes declined 3% year over year in the first half due in part to labor-related network service headwinds and harsh winter weather, but we expect 6%-8% growth on average in the back half on strength in coal, recovering grain and auto carloads, and better network fluidity (hiring progress). We note the late 2022 Canadian grain harvest is turning out to be far better than last year—a key driver of carload volume recovery in late 2022 through early 2023.

Despite service headwinds and cost inflation (including wages and benefits) in the first half, we bake in 140 basis points of OR improvement in 2022, to 59.7% (which includes wage accruals related to the tentative U.S. labor contract). Improvement should stem from the firm's renewed efficiency focus (including a return to its precision railroading roots) and leverage from solid core pricing and second-half volume growth. This also means we expect CN's OR gap relative to peers to narrow materialy after having lagged for a few years.

For 2023, we look for CN's revenue to grow 2%-3%. In our view, demand risk is elevated given inflation's threat to industrial production and retail end markets. However, we model 1%-3% volume growth in 2023 on continued tailwinds for grain and automotive shipments, including new wins on the project development front, partly offset by a softer macroeconomic backdrop. We suspect core pricing will remain positive next year, but we bake in flattish overall total yield on potentially lower fuel surcharges, normalizing accessorial income, and lower intermodal pricing due to heightened competition from easing contract rates in the trucking sector. On the margin front, we look for OR improvement to 57.5%-58% in 2023.

Over the long run, we expect CN's pricing power to prove sound (above rail inflation), as will its ability to neutralize diesel price shocks via surcharges. We assume a midcycle operating ratio of 57%-57.5%.

Risk and Uncertainty

Updated Oct 31, 2022

Our uncertainty rating for Canadian National is medium. CN is exposed to the health of the Canadian and U.S. economies, including both industrial and retail end markets. In our view, downside risk to freight demand is currently elevated due in part to inflation's threat to consumer goods spending.

Additionally, given the northern location of CN's assets, adverse winter weather can materially hamper efficiency by blocking tracks and necessitating shorter trains throughout certain times of the year. CN has exchange-rate risk, but relatively low coal exposure (indeed, the lowest proportional exposure among large railroads) mitigates volume lost to cheap natural gas as a power generation fuel source. Fuel price shocks are mostly mitigated via fuel surcharges.

In terms of environmental, social, and governance risks, because CN carries freight for chemical and energy end-market shippers, it is subject to the liabilities associated with hazardous material spills. Furthermore, the U.S. Surface Transportation Board oversees railroads' pricing, thus there will always be underlying risk of reregulation for some of CN's U.S. operations. That said, although there have been various discussions of reform over the years (including recent Biden administration commentary on forced switching), reregulation isn't a foregone conclusion. The STB's long-standing market-based approach has provided a balanced regulatory framework yielding a relatively small number of annual rate cases and reasonable outcomes that are often settled.

Furthermore, the rails have long faced the risk of more stringent safety regulation that could temper economic profit. The prime example is the U.S. Rail Safety Improvement Act of 2008, which required railroads to purchase and install positive train control at immense financial cost.

Capital Allocation Updated Oct 31, 2022

We award Canadian National a Standard capital allocation rating, which reflects our assessment that the rail's balance sheet is sound and the quality of its investing is fair and reasonable, and generally supports the rail's robust competitive positioning. We think shareholder distributions are appropriate.

CN was the pioneer in precision scheduled railroading principles 15-plus years ago under the leadership of railroading legend Hunter Harrison (from 2003 to 2009). We believe that operational excellence is generally infused in CN's culture, though growth versus margin improvement can be a delicate balancing act in railroading, and weather variability can have a marked impact on productivity and efficiency (especially in Canada). CN has long invested prudently in capacity (such longer sidings in port staging areas) to maintain high-quality operations and customer service, which in turn attracts new business opportunities. Also, CN isn't afraid to make opportunistic acquisitions, as with the Illinois Central in 1999 and the 2009 purchase of the EJ&E. EJ&E was a smart transaction, in our view, as it added a bypass around congested Chicago and has translated into increased network velocity--a key CN performance attribute. In 2018, CN acquired TransX, which provides refrigerated trucking and intermodal services.

In terms of management, in early 2018, CEO Luc Jobin left abruptly, and the board appointed JJ Ruest to take the reins. We note Jobin had not been a lifelong railroader, and came to CN as CFO in 2009. Ruest had been with CN for more than two decades, and before becoming CEO he spent eight years as executive vice president and chief marketing officer. We suspect the board favored his deep customer relationships.

In early 2022, CN selected Tracy Robinson--formerly a member of the leadership team at pipeline company TC Energy--to take the reins as CEO upon JJ Ruest's retirement at the end of February. For background, recall that last October, Ruest announced plans to retire in early 2022. At the time, we speculated that Ruest's decision was partly related to pressure from activist investor and large shareholder TCI Fund Management. Following CN's failed bid for Kansas City Southern and also due to CN's margin pullback in recent years, TCI has been pushing for a change in management and the board. Interestingly, as we understand it, TCI initially encouraged CN's board to oust Ruest and install the precision scheduled railroading specialist and recently retired COO of Union Pacific, Jim Vena. We suspect TCI hoped Vena would reinvigorate CN's operational prowess (and we would tend to agree with that potential), but in December he withdrew his candidacy.

Robinson was with TC Energy for about seven years and before she left she was EVP and president, Canadian Natural Gas Pipelines and president, Coastal GasLink--positions she held since late 2018. Prior to that it looks like she spent more than two decades at Canadian Pacific, including time as VP of marketing and roles in finance. Overall, based on commentary in the press release from the board chairman, we suspect Robinson has an impressive resume and is a seasoned leader. We also think her experience in the energy sector could help CN's business development efforts in that end market. That said, we were surprised CN didn't choose a candidate with more direct operational experience in railroading, and we suspect some investors may initially doubt the board's decision.

Of note, Ghislain Houle took on the CFO role in mid-2016 and was previously VP of financial planning since March 2007. The firm appointed current COO Rob Reilly in July 2019. Both Houle and Reilly are rail industry veterans, having served CN since 1997 and BNSF since 1989, respectively.

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