3 Big Challenges for Canadian National Railway This Earnings Season

Description

Canadian National Railway (TSX: CNR)(NYSE: CNI) is set to release its quarterly earnings on Tuesday. With the entire industry reeling from a savage winter, investors should brace themselves for an ugly report. Yet bad weather is not the only factor that will impact CN's earnings. Other problems threaten to put a damper the company's prospects.

Let's take an early look at what has been happening at CN over the past three months and what we're likely to see in this quarterly report.

Stats on CN Rail

Analyst EPS Estimate	$0.64
Change From Year-Ago EPS	4.92%
Revenue Estimate	$2.64 billion
Change From Year-Ago Revenue	7.20%
Earnings Beats in Past 4 Quarters	3

Source: Yahoo! Finance

How badly will CN's earning get hurt this quarter?

Analysts have cut their views on CN's earnings recently, down $0.09 per share for the upcoming quarter and off $0.04 per share for the full year. Yet this has not put a halt to the stock's rally with shares up 6% since the company last reported in January.

These lower expectations are mostly due to an unusually harsh winter. From snow in New Orleans to record low temperatures across the continent, bad weather has kept the railway from meeting all of its customers' demands.

Already we're seeing the impact of this year's polar vortex on rival operators. Last week, cold weather wreaked havoc on **CSX's** (NYSE: CSX) first quarter results. The company's accident rate rose, its on-time arrival rate plunged, and its dwell rate (the amount of time locomotives spend idle in railyards) skyrocketed. Notably, the firm's operating ratio — operating costs divided by operating revenues — increased by 520 basis points year-over-year to 75.5%. Investors should be worried about a repeat performance at CN this week.

In addition to bad weather, a record-shattering harvest has also created a grain handling backlog in Western Canada. The problem is that in an effort to protect farmers, the Federal government is drafting legislation to make sure railways deliver grain shipments in a timely manner. This heavy handed move could force CN away from more lucrative customers like auto parts for instance.

Finally, following the fallout from the Lac Megantic disaster, regulators are demanding railroad operators retrofit or replace their fleets to meet higher safety standards. In particular, the industry will be pushing out its old DOT-111 model crude tanker cars off the tracks. Back in February, CN announced that it has budgeted $2.1 billion for safety and efficiency upgrades this year, though shareholders should be worried that these costs might escalate further.

In CN's earnings report, listen closely to management's commentary on these issues. Investors should be looking for some ballpark figure as to how much these problems will impact the bottom line.

Foolish bottom line

While the upcoming quarter will probably be ugly for investors, here's the good news: bad weather is a temporary problem. Eventually the tracks will clear, the air will warm, and the railyards will start humming again.

CN is a wonderful business with irreplaceable assets. Despite the problems the company will face in the upcoming quarters, there's nothing here that challenges the long-term thesis to own the stock.

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