Canadian National Railway Company: Can the Good Times Roll On?

Description

Canadian National Railway Company (TSX: CNR)(NYSE: CNI) announced results for another excellent quarter on Tuesday. The results were, in one word, fabulous. Some of the highlights are discussed below.

Its third-quarter financial performance was outstanding

CN Railannounced earnings per share of $1.04 for the third quarter, which was 24% ahead of the comparable quarter last year. This was slightly weaker than the $1.05 per share expected by the market consensus forecasts. Revenue was up by 16% driven by higher intermodal, petroleum, and grain volumes as well as freight increases. Operating expenses jumped by a somewhat-worrying 14% with the largest components, fuel and labour increasing by 14% and 11%, respectively.

The cash flow of the business remains extraordinary strong with operating cash flow jumping by 32% in the first nine months compared to the same period a year ago. Free cash flow (that is operating cash flow minus capital expenditures) was equally buoyant with an increase of 50% to $1.9 billion for the first nine months of the year.

The company also announced a dividend of $0.25 per share for the fourth quarter which is 16% more than a year ago. In addition the board approved a new share repurchase program which allows for the purchase of 28 million shares (3.9% of outstanding shares) until October 2015. In the past 12 months $1.4 billion was spent on the purchase of 22.3 million shares at an average price of $62.78.

… and so was the operational performance

Operationally, the company reported a very successful quarter with improvement in key measures such as revenue per ton mile, revenue per carload, labour productivity, and fuel efficiency.

The operating ratio, which measures operating expenses as a portion of revenues, improved further to an industry standard setting level of 58.8% from 59.8% in the comparable quarter last year. Although the third quarter normally represents a seasonally low for the operating ratio, the full-year ratio should now be in the low 60s, its best performance in many years.

The company predicts a sound final quarter and hints at a continuation of the good times into 2015

The full-year 2014 outlook as provided by company management indicates "solid double-digit earnings per share growth…" and high-single-digit carload (volume) growth and price increases above inflation. Consensus forecasts now indicate earnings per share growth of 20% for the full year.

Management has not as yet provided a formal outlook for 2015, but the positive performance of a number of the main sectors, including grain and crude oil, is expected to continue into the fourth quarter and beyond.

… but the valuation of the stock remains full

The company has delivered an outstanding result for the first nine months of the financial year. Volume growth is solid and expected to continue in key sectors. Pricing power is allowing for freight rate increases further improving profitability and cash flow. Heaps of cash is returned to shareholders through dividends and share buybacks.

However, most of this good news story seems to be incorporated into the share price. Based on consensus forecasts, the price-to-earnings ratio for the full financial year 2014 is 20 times, 18 times for 2015, and 17 times for 2016. For the 2015 valuation, this represents a premium of 15% to the other Class 1-listed North American railroad operators (excluding **Canadian Pacific Railway Limited** (TSX: CP)(NYSE: CP)) and a 25% premium to its own valuation history.

Despite an 18-year record of uninterrupted and growing dividends, the dividend yield on the stock is now a measly 1.4%. Even if it continues to grow at the historical pace of 16% per year, it will take many years to reach an attractive level.

CATEGORY

1. Investing

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