Why Canadian National Railway Company and Canadian Pacific Railway Limited Don't Really Have to Worry About Oil's Slide

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With oil prices plunging, many different winners and losers are emerging. The energy companies are the obvious losers, and their misery may continue for a while.

But what about the rails? After all, with Canadian oil in serious flux, crude-by-rail faces an uncertain future too. Making matters worse, low oil prices benefit rail's main competitor, trucking. As of this writing, the shares of **Canadian National Railway Company** (TSX: CNR)(NYSE: CNI) and **Canadian Pacific Railway Limited** (TSX: CP)(NYSE: CP) are
each down by 6%.

That being said, these concerns are likely overblown. Below we present three reasons why.

1. Crude-by-rail is not really a headwind

The crude-by-rail boom has drawn plenty of newspaper ink. But its share of rail revenues is a lot more muted.

For example, last year crude accounted for less than a quarter of "petroleum & chemicals" revenue at CN Rail, and less than 5% overall. The story was quite similar at CP. Granted, these revenues are growing very quickly. But they're still a small piece of the overall pie.

Furthermore, low oil prices may force some producers to scale back, but they aren't going away. And with no new major pipelines being built, these producers still need rail to get their product to market.

2. Lower diesel prices benefit the rails too

One has to remember that diesel is a major cost to these rail operators. In 2013, fuel accounted for 24% of expenses at CN Rail, and 21% at CP.

So with operating margins at 35-40%, you can see just how beneficial a fuel price slide can benefit the railroads. It will take a while for these benefits to show up in the numbers – both companies charge their customers extra when fuel prices are high (these extra revenues will of course now disappear). But in the long term, lower fuel prices will make these companies' operations healthier.

Of course, trucks will benefit even more; fuel accounts for about 40% of a trucker's cost. But rail is still far lower-cost than trucks, and the U.S. trucking industry is facing a driver shortage too. So rail should continue to deliver.

3. Lower oil prices help the economy

When Warren Buffett bought Burlington Northern Santa Fe in 2009, he called it a one way bet on the American economy. And the American economy should benefit greatly from oil's slide. Most industries should see their costs go down. And regular people will have more money in their pockets. The benefits are very widespread.

As a result, American businesses and consumers may be more liberal with their wallets and purses. And in order for the shelves to stay stocked, the rails will be needed as much as ever. CN and CP have little to worry about.

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