Is Canadian National Railway Company at the Peak of its Game?

Description

Canadian National Railway Company (TSX:CNR)(NYSE:CNI) announced results for another excellent quarter on Tuesday. To my mind the company performance resembles that of a top athlete in peak form.

Outstanding Q4 financial performance

CN Rail announced earnings per share of $1.03 for the fourth quarter, which was 36% ahead of the comparable quarter last year and slightly better than the $0.98 per share expected by the market consensus forecast.

Earnings per share for the full year came in a $3.85 per share, 25% more than 2013. The excellent performance was helped along by the reduction in the number of shares in issue as a result of a share repurchase program that added about $0.11 per share while the weaker Canadian dollar added $0.15 per share.

Revenue increased by 17% in the quarter and by 15% for the full year. This was the result of strong performances in petroleum and chemicals, grain and fertilisers, and metals and minerals. Higher volumes, price increases and the weaker Canadian dollar all contributed to make this a record year for the company.

Operating expenses jumped by a somewhat worrying 10% in the quarter and by 12% for the full year with both labour and fuel increasing by more than the rate of inflation. Surprisingly, the fuel bill, which is the second largest operating expense, increased by 6% in the fourth quarter despite lower fuel prices. With diesel fuel prices currently more than 20% below the CN Rail 2014 average, lower fuel costs could provide a kicker to profits in 2015. On my calculation, a 10% drop in fuel costs could result in a 3.5% increase in operating profits.

The cash flow of the business remains extraordinary strong with operating cash flow leaping by 24% for the full year while free cash flow (that is operating cash flow minus capital expenditures) increased by 39% to $2.3 billion for the year.

The company also announced a dividend of $0.3125 per share for the fourth quarter which is 25% more than a year ago. In addition, the company repurchased 22.4 million shares during the year for a total spend of $1.5 billion at an average price of $67 per share.

The operational performance improved… again

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 in the final quarter to an industry standard-setting level of 60.7%. The full-year ratio averaged 61.9%, which represents one of the best years for CN Rail on record.

Management is now expecting earnings per share to increase by "double digits" in 2015. The positive outlook is linked to further growth in energy related commodities, intermodal traffic, lumber, and automotive transport.

The stock remains fully valued

The company has delivered an outstanding result for the 2014 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. Cash is returned to shareholders through dividends and share buybacks.

However, most of this good news is incorporated in the share price. Based on the indications provided by management, the price-to-earnings ratio for the full financial year 2015 is 20 times. For the 2015 valuation, this represents a premium of 20% to the other Class 1 listed North American railroad operators (including **Canadian Pacific Railway Limited**) and a 40% premium to its own valuation history.

Despite a 19-year record of uninterrupted and growing dividends, the dividend yield on the stock is still a measly 1.4%. Even if it continues to grow at the historical pace of 17% per year, it will take many years to reach an attractive level.

CATEGORY

1. Investing

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