

Canadian National Railway Company: A Solid Dividend Growth Stock

Description

Canada's largest railway company, **Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)), continues to impress analysts and investors with its performance. However, the rout in crude and fears of weaker Canadian economic growth are certainly casting doubts over whether the company can continue to grow at such a spectacular rate.

So what?

Canadian National's latest quarterly results were impressive. For the fourth quarter of 2014, it reported record results, with net earnings of \$844 million, a whopping 33% increase over the same period in 2013. This can be attributed to strong results from its core operations, with car-loadings up by 8% and higher traffic volumes.

One of the biggest drivers of Canadian National's solid financial results is the significant increase in oil and other petroleum products transported by rail because of the lack of pipeline capacity. For the full year 2014, revenue from petroleum and chemical transportation jumped a very healthy 21% compared to 2013. Higher freight volumes can also be attributed to a record 2014 Canadian grain crop.

The strong results saw the company hike its dividend by an impressive 25%, giving it a 1.4% dividend yield and a very sustainable 32% dividend payout ratio.

However, this leaves investors with a question.

Can Canadian National's earnings continue growing at this rate?

The rout in crude prices will certainly have a short-term impact on the volume of crude transported by rail, with the majority of the energy patch's oil producers slashing capital expenditure for oil production and well development. This will see production volumes of oil taper off in the foreseeable future, but I expect demand for crude by rail to remain strong and grow over the long term.

Despite softer crude prices, Canadian crude production between now and 2020 is still expected to grow at an average of 5% annually. Furthermore, the lack of sufficient pipeline capacity still makes the patch dependent on rail as an important means of transporting crude to refining markets.

In addition, the International Energy Agency expects global demand for oil to continue growing over the long term, which will support growing demand for Canadian crude. In fact, the agency recently stated that it expects Canadian oil output to continue increasing, and this is virtually a given considering Canada has the world's third largest oil reserves.

Another positive for freight volumes is the growing strength of the U.S. economy, which will increase cargo demand across North America as well as cross-border trade between Canada and the U.S. This increased demand will also see pricing moving in favour of the freight rail providers.

Each of these factors bodes positively for Canadian National to continue growing earnings and meet its target of generating double digit earnings-per-share (EPS) growth in 2015.

An important aspect of Canadian National's operations is that it holds a dominant position in the provision of freight by rail in Canada because it has the country's largest rail network. The sheer size of this network, the massive capital investment required to duplicate it, and steep regulatory barriers endow Canadian National with a wide, multifaceted economic moat. This reduces competition and protects the company's competitive advantage while helping to stabilize earnings growth.

All these factors leave Canadian National well positioned to continue growing earnings and rewarding investors through further dividend hikes.

Now what?

While Canadian National does appear expensive on the basis of a range of valuation metrics, it is a strong growth stock that is well positioned to achieve the goal of double-digit EPS in 2015. This will allow it to continue rewarding investors through a steadily growing dividend while further earning growth will see its share price appreciate.

CATEGORY

1. Dividend Stocks
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