The Case to Buy the Canadian National Railway Company

Description

If only every stock I picked was like the **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI).

Since I wrote my first column about the stock back in November 2013, shares of the railroad giant have delivered a 40% total return, including dividends. During that time, the company has hiked its distribution by more than 45%!

Of course, you can't buy past returns. However, there's reason to believe that CN will continue to post steady profits for shareholders. Now, where the stock goes in the short term is anyone's guess. But over the long haul, I expect investors will be well rewarded.

Here's why.

1. CN has a big wide moat

In days of yore, a castle was protected by the moat that circled it. The wider the trench, the more easily a castle could be defended. The same is true in business. The castle is the company and the moat is the competitive advantage the business has. We want the trench around the operation to be broad and deep in order to fend off all competition.

CN has a moat more than a mile wide that is filled with angry mutant alligators. The company's rail lines were laid nearly a century ago, back when land was cheap. Over time, cities, towns, and businesses have been built around these tracks.

There's no way you could replicate CN's network today. The cost to secure the needed right of ways and buy out every landowner would be in the hundreds of billions of dollars. As a result, CN is able to crank out oversized profits year after year without the worry of new rivals eating into margins.

Rail is also the cheapest method of shipping goods over long distances. Today's trains can move a ton of freight more than 180 kilometers on a litre of diesel. That's four times more fuel efficient per ton-mile than trucking.

This gives railroads a permanent cost advantage. So, as long as we're moving stuff around this country, CN is going to get its share of the business.

2. CN cranks out dividends

This competitive advantage means CN is gushing profits that it passes on to shareholders.

Since 2010, the company has more than doubled the size of its dividend. Today, the stock pays out a quarterly distribution of $0.31 per share, which comes out to an annual yield of 1.5%.

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Source: CN Investor Relations

However, dividends are only one part of this story. CN also has a ravenous appetite for its own shares. And when the company buys back its own stock, it shrinks the total number of shares outstanding.

Here's how it works. Let's say in 2010, you purchased 10 million CN shares. Back then, the company had about 1 billion shares outstanding, which means you owned 1% of the total investor pie. Since then, CN has bought out nearly 20% of its investors, taking down the total share count to about 800 million. You still own 10 million shares, but now your position represents 1.25% of the company.

This is why I love buybacks. Without adding a single share, we were able to increase our stake in a wonderful business *tax free*.

3. CN is a bet on Canada

Because of the company's strategic position in the country, CN is a wager on Canadian prosperity. However, I have always considered an all-in bet on Canada's economic future to be pretty much a sure thing.

Now, it won’t be a smooth ride. During the next century, you can expect 15 or so bad years. And of course, no one can predict in what order they’ll occur. But over the next 100 years, we’re going to have more people living in this country. In time they’re going to use more goods. CN will play a vital role in moving those products across the nation.

Bottom line, if you’re looking for a stock to impress your friends, then CN isn’t for you. But if you like good old fashion dividends and are willing to trade being the life of your next cocktail party for reliable profits, then you’ll like this stock just fine.

CATEGORY

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2. Investing

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