The Case to Buy the Canadian National Railway Company in 3 Charts

Description

When it comes to dividend stocks, sometimes good things come in small packages. Consider the **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI).

Over the past 10 years, the stock's yield has averaged a measly 1.5%. Yet CN shares have grown steadily, producing a jaw-dropping total return, including dividends, of 410% over the same period.

You can't buy past returns, of course. But there's reason to believe that CN will continue to crank out solid profits. Where the stock goes in the short term is anybody's guess. However, over the long haul I expect investors will be rewarded nicely.

Here's why:

1. CN has an impenetrable moat

Business isn't much different than HBO's hit TV show *The Game of Thrones*. When you're running a profitable operation, it's like being the king of an economic castle.

In a free market, people always want to take your crown. What you need is some sort of durable competitive advantage, like a moat, that protects the business. The wider and deeper a moat is, the better.

The best way to determine whether or not a company has a moat is to measure its return on invested capital, or ROIC. This is calculated by taking the net operating profits earned after taxes and dividing it by the amount of debt and equity that has been invested in the business.

Typically, if a company has an ROIC in excess of 7% or 8% for a number of years, it most likely has a moat. Let's see how CN stacks up…

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Source: Corporate filings

As you can see, CN has been able to generate a steady double-digit ROIC for a decade. You won't find many businesses like this. This tells me the company has a moat more than a mile wide.

Why is this the case? CN's network of track was laid nearly a century ago, back when land was cheap. Over time, cities and towns have been built around these rail lines. Even if you and I could scrape together a few billion bucks, there's no way we could buy out all of the landowners or secure the right-of-ways needed to enter the business.

That means CN's network of track is almost impossible to replicate. As a result, the company is able to crank out oversized profits year after year without the worry of new rivals eating into margins.

2. CN pays a solid dividend

Most of that excess cash is funneled right back to investors. Since going public in 1996, the company's payout has increased by nearly 15-fold. Even through the worst of the financial crisis, CN never skipped a single dividend payment to shareholders.

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Source: Corporate filings

CN also returns an enormous amount of cash to investors through buybacks. When a company repurchases its own stock, it shrinks the number of shares outstanding. That means you own a larger percentage of the business.

Let's say you bought 13 million CN shares back in 2005. At the time, CN had about 1.3 billion shares outstanding, which means you owned 1% of the total investor pie. Since then, CN has bought back nearly 320 million shares. You still own your 13 million shares, but your position now represents 1.3% of the company—about one-third more than what it did before.

It's like a "secret dividend." Without doing anything, you were able to increase your stake in a wonderful business.

3. It’s not outrageously expensive

Notice I didn’t say the stock is cheap—it isn’t. After the recent run-up, I wouldn’t use the word “bargain” to describe CN shares. But like most things in life, sometimes you get what you pay for.

My favourite quick-and-dirty method to measure value is EV/EBITDA. This is calculated by taking a company’s enterprise value (the sum of a firm’s debt and equity less cash) and dividing this figure by its earnings before interest, taxes, depreciation, and amortization.

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Source: yCharts.com

Today, CN trades at about 11 times EV/EBITDA. That’s a premium multiple, but it’s in line with peers and within the company’s historical average.

Bottom line, CN is a wonderful business. I expect patient investors will likely be rewarded with growing profits, dividend payments, and a stock price that—though volatile in the short term—should steadily rise over time.

CATEGORY

1. Dividend Stocks
2. Investing

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