4 Simple Reasons to Hold Canadian National Railway Company

Description

Canadian National Railway Company (TSX:CNR)(NYSE:CNI) has been a fantastic investment for most of the past five years, but a recent pullback has investors wondering if they should buy, hold, or sell the stock.

Here are the reasons why I think the company deserves to be in your portfolio.

1. Huge barriers to entry

Railway companies operate in an industry that has massive barriers to entry. In fact, the odds of someone building a new rail network in North America are pretty much zero.

That means the existing companies have little or no rail competition on many of their routes and simply have to compete with other forms of transportation.

Canadian National is in a unique position because it is the only rail operator that can offer customers access to three coasts. As international trade continues to grow, this becomes more important.

Canadian National has been working hard to leverage this advantage by investing in intermodal hubs along its network. In 2015 about $800 million is earmarked for intermodal terminals.

This helps Canadian National compete with trucking companies because customers can use it to get their products from the port to a major hub, where it can be transferred to a truck for the last leg of the trip.

2. Productivity gains

Along with the intermodal investments, Canadian National plans to spend $1.4 billion this year on track infrastructure and $500 million on equipment, including 90 new locomotives. The commitment to improving the efficiency of its operations is the main reason Canadian National is regularly cited as North America's best-run railway.

In its Q1 report Canadian National said it had improved its operating ratio to 65.7% compared with 69.6% in the first quarter of 2014.

3. Earnings

Despite the slowdown in crude-by-rail shipments, Canadian National reported strong year-over-year Q1 earnings. Net income came in at $0.86 per share compared with $0.75 last year. Revenue ton-miles increased by 7% and total carloads were up 9%. The company transports a wide variety of goods and commodities. While coal and oil are currently weak, lumber, automobiles, and intermodal continue to see strong growth. This diversity ensures a balanced revenue stream.

4. Dividends and share buybacks

Canadian National is a dividend-growth machine. The company increased the payout by 25% earlier this year and plans to give shareholders a higher percentage of the profits moving forward. This means distribution increases should continue in the coming years. Canadian National has raised the payout every year since 1996.

The company also has an aggressive share-repurchase program.

Risks

There are some short–term risks to be aware of and these are responsible for the recent pullback in the stock. New regulations on both sides of the border will mean higher costs for the crude-transport segment because carriers are required to upgrade their oil cars to meet new safety requirements. At the same time, the cost advantage of sending oil by train is narrowing, so Canadian National and its peers will have a difficult time passing on the higher expenses to their customers.

Should you buy Canadian National Railway?

The current challenges are short term in nature when you are looking at a multi-decade investment. As a long-term play, investors should be comfortable holding the stock and the current downturn is offering a good opportunity to pick up the shares at 16 times forward earnings, which is a reasonable price for this company.

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aswalker