Weak Commodities Prices Won't Impact Canadian National Railway Company

Description

Soft commodity prices and a weak Canadian economy continue to weigh heavily on the demand for bulk transport and the outlook for Canada's railways. Despite this, Canada's largest railway network **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) continues to perform strongly, and I expect it to continue doing so regardless of the headwinds facing the North American rail industry.

Now what?

One headwind that is having a marked impact is the significantly weak demand for crude oil and coal. The collapse in oil is being touted as one of the key risks for Canadian National and **Canadian Pacific Railway.** This is because it is expected to trigger a considerable reduction in the demand for crude transportation with Canadian oil output expected to fall as energy companies slash investments in developing existing and new oil assets.

However, this is not shaping up to be a major headwind as claimed.

Despite investments in the energy patch falling sharply over the first half of this year, Canadian oil output continues to rise, albeit not as fast as it had before the oil rout. This rising output coupled with constrained pipeline capacity will continue to generate demand for alternate means of transporting Canadian crude to key refining markets.

One of the most cost effective and safest means of doing so outside of pipelines is by using rail.

Canadian National is Canada's only rail company with a truly transcontinental railway network. It reaches as far as the U.S. Gulf Coast, giving it access to those vital refining markets and a key advantage over its competitors.

These factors are most certainly one of the reasons that revenue from the volume of petroleum transported for the first half of 2015 grew by a modest 1% year over year.

While I expect demand for crude by rail to decline from where it was before the oil crash, it will continue to be lucrative market for Canadian National for as long as pipeline capacity remains constrained.

Given the controversy surrounding the Keystone XL and Northern Gateway pipelines, and the long lead in times to develop and construct oil pipelines, I don't expect this problem to be resolved quickly.

Another main headwind is the significant decline in demand for coal. This can only continue to gain momentum because governments are focused on reducing the amount of electricity generated by coal-fired power plants.

As Canada is one of the largest consumers of coal in North America, the gradual elimination of coal-fired power doesn't bode well for the coal industry. This will impact the entire value chain, all the way from the miners who dig it out of the ground, to those who transport coal.

Coal is a key bulk freight item that has been particularly profitable for North American railways. It makes up a considerable portion of the total cargo transported. Despite this, I don't believe it will have as much of a marked impact on Canadian National as it will on some of its peers. Canadian National has a relatively low degree of exposure to coal, only making up 7% of revenue generated from freight volumes for the first half of 2015 compared with 16% for Canadian Pacific and 15% for **Union Pacific Corp.**.

So what?

Clearly, it is not all clear sailing for North America's railways as a range of headwinds are set to adversely impact freight volumes, but Canadian National remains well positioned to sidestep the fallout from these headwinds. This, its wide economic moat, and dominant market position make it a core holding for every portfolio.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. TSX:CNR (Canadian National Railway Company)

Category

1. Investing

Date
2025/08/21
Date Created
2015/08/13
Author
mattdsmith