



## Why Canadian National Railway Company Has Outperformed its North American Peers This Year

### Description

It has been a bad year for North American railway stocks. The TD Securities Railway Index—an average of North America's five major railway stocks—is down over 23% for the year, and this performance is significantly worse than both the TSX and the S&P 500.

The major reason for this decline is the strong link between railway stocks and tumbling commodity prices, coal in particular. U.S. railways earn about 20% of revenues from transporting coal, and Canadian railways earn about 8% of revenues from coal. Declining coal volumes have weighed heavily on rail stocks.

**Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)), however, has been largely insulated from the downturn. While the stock is down 4.5% year-to-date, it is looking much better than the TSX, which is down 10%, and **Canadian Pacific Railway Limited**, which is down 11%, or any of the U.S. rails.

Here's why CN has outperformed.

### CN has a diversified business model

At the heart of CN's outperformance is its diversified business model. CN is diversified geographically, across customers, and across business segments. The areas where it is slightly concentrated are generally linked to positive macroeconomic trends.

For example, CN's largest customer only provides 3% of total revenue (compared with CP, whose largest customer accounts for 10% of revenues), and CN's top five customers only account for 12% of revenue.

The company is also not overly focused on one product category. For example, coal only accounts for 5% of CN's revenue (compared with 10% for CP), and grains and fertilizers only account for about 16% of CN's revenue. CP obtains about 42% of total revenues from grains and fertilizers.

Grains, fertilizers, and coal are by far the biggest drags on rail volumes over the past year, and have been largely responsible for declines in railway revenues (along with petroleum products). The outlook for both coal and grain is weak in 2016, and CN's limited exposure to these products will allow the company to minimize revenue effects from volume declines in these areas.

Most importantly, CN's diversification means it is also exposed to product categories that are experiencing growth. CN has a large exposure to intermodal, forest products, and the automotive industry, and these three segments comprise about 41% of revenues.

CN saw an 8% increase in automotive carloads in Q2 2015, and 6% increase in intermodal carloads. Forest products saw a small decline of about 1%. The key factor all these segments have in common is exposure to the U.S. consumer, and with U.S. unemployment at a seven-year low and U.S. home-builder confidence at a decade high, CN is poised to benefit.

CN's diversified model allowed it to see volume growth in certain segments, and combining this with freight rate increases, increases in average length of haul, and reductions in operating costs means CN can generate earnings growth despite the major market headwinds.

### **CN has also been reducing costs**

Part of CN's outperformance is also linked to its industry-leading low operating costs. CN is North America's most efficient railroad, with costs equal to only 56% of revenues in Q2/2015—far lower than its peers.

CN quickly responded to the declining volume environment by reducing headcount, reducing overtime, lowering training costs, and implementing a hiring freeze. Overall, the company reduced operating expenses by 5% from Q2 2015, and these reductions combined with an increased focus on efficiency allowed CN to post an earnings increase of 12%

### **CATEGORY**

1. Investing

### **POST TAG**

1. Editor's Choice

### **TICKERS GLOBAL**

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:CP (Canadian Pacific Railway)
3. TSX:CNR (Canadian National Railway Company)
4. TSX:CP (Canadian Pacific Railway)

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amancini

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