



The Top 3 Reasons to Own Canadian National Railway Company

Description

If you are considering **Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)), it is good company. It has consistently been one of Bill Gates's top stock preferences—a core holding of both his charitable foundation as well as his personal portfolio via Cascade Investments.

The investment has paid off—CN has generated a compound annual growth rate of nearly 20% over the past 20 years. CN's outperformance comes from the fact that it is a top-tier stock in an industry with a wide economic moat.

Rails serve as the backbone of the economy and possess massive barriers to entry, which virtually ensures that no new railways will be built. They are the lowest-cost way to transport goods across land and are the only way to transport certain bulk commodities where barge transportation is unavailable.

Going forward, there are three main ways CN will leverage its unique rail network and business mix to generate outperforming returns for shareholders.

1. The best-in-class international intermodal franchise will provide growth

Twenty-three percent of CN's revenue comes from its intermodal segment, and about 62% of this comes from the international intermodal segment. International intermodal refers to the transportation of a single container of goods from ships to inland destinations via CN and vice versa.

This business has so far been a tremendous source of growth, with volume to and from U.S. markets growing by a 21% CAGR since 2009, and volumes to and from Canadian markets growing by 11% since 2009. This growth comes from the fact that CN has a dominant presence in this space.

CN currently has a unique rail network, which has access to the east coast, the west coast, and the Gulf of Mexico. It also has the fastest route in and around the critical Chicago area as well as access to a massive range of inland destinations.

Combine this with the fact that CN has access to five ports and is the primary service provider to 16 of 19 of the shipping lines that call at Canadian ports, and CN's competitive advantage is clear.

Recently, CN won three international intermodal contracts with overseas shippers from CP Rail, and this should serve as validation of CN's strength in this area.

There is also significant growth opportunity. There are major port expansions occurring at both the Port of Vancouver and the Port of Prince Rupert as well as at the Ports of New Orleans and Mobile, all of which CN should benefit from.

2. CN has excellent U.S. exposure, which should provide growth

Railways are largely plays on underlying economic growth, and the U.S. economy is expected to fare significantly better over the next several years than the Canadian economy. This is especially true for the U.S. housing market; housing starts recently reached an eight-year high and are expected to grow further into 2016.

Strong housing in the U.S. is a by-product of strong employment, incomes, and relatively low debt levels. CN is uniquely positioned to benefit from all of these trends.

About 13% of CN's revenue comes from forest products, and the U.S. is the primary destination for most of CN's forest products. As the U.S. housing market continues to improve, demand for lumber and panels from western Canada will continue to grow, and CN is well positioned to benefit.

CN also has excellent exposure to U.S. consumer spending through its intermodal segment. About 30-40% of CN's international intermodal segment is to and from the U.S. economy, and about 25% of CN's domestic intermodal segment is to and from Mexico. Since these are largely consumer goods, CN benefits from improving consumer spending.

CN is also poised to benefit from the surging U.S. auto industry, which is benefiting from a strong economy, easy credit, and an aging fleet of vehicles. CN serves shippers of import vehicles, and has direct access to 17 assembly plants in Canada and the U.S.

3. CN has an excellent record of returning capital to shareholders

CN shareholders have and will continue to be able to rely on the company returning capital via dividends and share buybacks to bolster returns. The company has grown its dividend by a CAGR of 17% since 1995, and this pace is poised to continue as the company recently committed to boosting its payout ratio from about 28% to 35%.

CATEGORY

1. Investing

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