Is Canadian National Railway Company on Sale?

Description

After a five-year run of positive returns and seeing the stock appreciate by over 100%, shares of **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) are in a bit of a rut. Shares are down 7% in the past 90 days and have been relatively flat since early 2014.

While the company has shown an ability to outperform the market over the long term, is the recent dip a buying opportunity or an indication of troubles to come?

Industry in transition

Canadian National Railway isn't the only rail operator facing headwinds. **Norfolk Southern Corp.**, **CSX Corporation**, and **Union Pacific Corporation** are all down more than 30% in the past 12 months. One of the biggest factors contributing to the industry's decline is the collapse in oil prices.

When the price of oil was over $100 a barrel, oil and gas companies were scrambling to get supply online despite the lack of infrastructure necessary to transport the additional volumes. The explosion of shale drilling just exacerbated this issue. Without enough pipelines in place (which take years to plan, permit, and build), oil and gas companies were forced to use rail cars to ship huge volumes of fuel. Almost overnight, crude by rail became one of the biggest drivers of profitability growth for most railroad operators.

Crude by rail was helpful for two reasons.

First, it gave railroads an unexpected revenue boost. Historically, sales were only influenced by the health of the overall economy and the price of substitute shipping methods such as trucking. Getting a sizable revenue boost independent of those two factors caused the market to place a higher valuation on rail stocks.

Secondly, shipping oil is often more profitable than transporting other items. While a toy manufacturer has dozens of options for transportation, an oil field may have only one (a nearby railroad). Pricing power was exceptional.

Not immune to widespread struggles

Like its peers, Canadian National Railway was a major benefactor of crude by rail. In 2010 the company shipped only 216 rail cars of oil. By 2014, that had risen to an astounding 128,000 carloads. Shipments of fracking sand also followed suit, rising nearly four-fold over the same time span.

For 2015, shipments of oil are only expected to be around 100,000 carloads, a decline of over 20%. While energy only represents a minority of sales, its higher profitability hits the bottom line at a time when the Canadian economy is slowing and investor sentiment is hitting new lows.

What's next for shares?

If oil prices remain depressed, Canadian National Railway's business has very few tailwinds behind it. While its impact varies by province, the Canadian economy as a whole still fluctuates in tune with oil. Lower oil prices for longer means a continued decline in crude-by-rail shipments (which would have a long time to go before bottoming) as well as continued pressure on the economy. Plus, lower fuel prices make substitute forms of shipping more attractive.

If you're tempted to bite on railroad shares, you better believe higher oil prices are around the corner. If not, profits still have plenty of room to continue compressing.

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1. Editor's Choice

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