



Stella-Jones Inc. Shares Have Returned 1,000%+ Over 10 Years: Can the Run Continue?

Description

While **Stella-Jones Inc.** ([TSX:SJ](#)) isn't the most talked about public company in Canada, it has quietly put up incredible long-term results. In 10 years shares are up 1,311% compared to the TSX index return of just 5%. As the country's leading producer of pressure-treated wood products, you may think that the company has been a benefactor of the healthy real estate market. The company's true saviour is something very different.

Railroads pave the way for profits

Company sales went from \$652 million in 2011 to \$1.5 billion this year. About 50% of Stella-Jones's products go towards railway ties (the wood blocks that hold metal rail tracks together). Another third of sales is comprised of utility poles. Only 12% of the business is related to the residential sector.

Rail transportation exploded as a result of higher economic activity and sky-high oil prices (making alternative forms of transportation more expensive). The number of carloads on North American railroads has continued to climb nearly every year this decade, leading to new lines being built and increased wear and tear on existing lines, resulting in faster replacement cycles. Whether building new lines or repairing old ones, Stella-Jones is turning a profit.

Is railroad growth peaking?

While general economic growth has boosted railroad volumes, the biggest growth factor has been a relatively new form of revenues: oil shipments. With oil averaging over \$90 a barrel from 2006-2014, most oil and gas producers were doing everything possible to ramp supplies quickly. Meanwhile, a massive amount of production came from previously unheard of sources, including shale oil and oil sands.

Because production came on quickly, the transportation infrastructure necessary to support burgeoning supplies lagged behind. Typically, pipelines can take years to plan, permit, and build. Instead, oil and gas companies tapped railroads to ship oil by rail car.

In just five years crude by rail grew from less than 1,000 carloads per year to the 100,000s. This boosted sales, but grew earnings even more, as crude by rail is incredibly profitable. Pricing power was strong because oil companies often had to ship their production using rail networks.

When railroads were flush with cash and volumes, operators spent heavily on maintenance and new projects, and this greatly benefited Stella-Jones. With commodity prices tumbling, the CEO of **CSX Corporation** believes the North American rail industry just entered a “freight recession.” While it may take a few quarters to sort out, rail spending is certainly set to fall unless commodity prices improve considerably very soon.

The past is over

While investors think they are buying a wood producer, shares of Stella-Jones are heavily influenced by oil prices. Without high oil prices, railroads are less profitable. Lower profitability will eventually translate into decreased spending. As major customers of Stella-Jones, this has the potential to derail a decade-long history of growth.

At 25 times earnings, Stella-Jones’s current valuation is actually considerably higher than its five-year average of just 19 times earnings. With the best years behind it, an investment in the company today is likely a misguided idea.

CATEGORY

1. Investing

Category

1. Investing

Date

2025/08/26

Date Created

2016/01/15

Author

rvanzo

default watermark