Insiders Are Buying Canadian National Railway Company: Should You?

Description

With its shares down over 20% in the past 12 months, insiders are finally starting to bite on **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) stock. This month insiders bought 56,800 shares for a total of $4,022,228, implying an average share price of about $71. With the stock still hovering around that range, should you follow suit as management ups the ante?

The good and bad

The company released fourth-quarter earnings this week, and things were surprisingly rosy. Earnings per share were up around 15%, primarily driven by efficiency gains in nearly every aspect of the business. Train productivity, shipment speed, and locomotive utilization were all up around 3%. With $4.25 per share in full-year earnings, the stock now only trades at 16.8 times earnings, seemingly cheap compared with its five-year average of 17.7 times.

Before you dive in, however, the rail industry as a whole is currently facing some massive headwinds. While Canadian National Railway has been able to grow earnings in recent quarters, that's largely based off higher operating efficiencies, not a stronger underlying business. For example, carloads were actually down 8% last quarter, driven by major declines in shipments of grains, coal, and minerals.

Fortunately, revenues ended up roughly flat as the company was able to boost prices by about 8%. While pricing power can stem the tide for now, it's hardly a long-term solution to declining carloads. If demand continues to drop for their services, pricing power will eventually erode.

How will 2016 fare?

How much more pain could Canadian National Railway feel? The collapse in commodity prices has crushed industry supplies, resulting in less product needing to be shipped. The spillover into rail volumes may be in the early innings.

Nearly every major commodity, from coal, to oil, to gold, is seeing massive spending cuts by producers. While the market will normalize at some point, most are expecting supply to dip in 2016. Recent industry data shows that Canadian railroads are shipping 68,493 carloads a week, down 8.3%

compared with the same week in 2015.

Even Canadian National Railway management thinks 2016 will be tough, citing a “very challenging environment for energy-related commodities.” In the company’s latest conference call, its chief marketing officer stated that they “are not counting on a rebound in commodities.”

This year, management expects carloads to experience a decline yet again. Surprisingly, analysts expect both revenues and profits to grow by over 3% this year, indicating that the market still believes the company can pass along price increases to customers despite falling volumes.

What to do

At current levels, an investment in Canadian National Railway should hinge on either two things: a belief that the company can continue to find efficiencies and raise prices, or that commodity prices will improve in 2016.

With the stocks valuation not too far off its five-year average, there isn’t too much margin of safety if the company can’t drive costs down or boost pricing. And if you believe management, it doesn’t look like energy-related shipping will rebound this year. If you want to follow insiders and buy shares, you’re better off waiting for a cheaper price.

CATEGORY

1. Investing

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