How the Weak Loonie Helps Canadian National Railway Company

Description

Over the course of the past year we've seen some growing concerns surrounding Canada's leading railway, **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI).

Of course, the biggest of these worries is the decline in commodity prices, which has an impact on shipping volumes. But there is another trend working in CN's favour: the weak loonie.

We take a closer look below.

Why the weak loonie is generally a positive

CN gets more than half of its revenue in U.S. dollars but incurs the bulk of its expenses in Canadian dollars. This means that when the loonie declines relative to the U.S. dollar, expenses decline relative to revenues.

What was the impact?

In its most recent annual report, CN estimated that each one-cent change in the Canada-U.S. exchange rate impacts earnings by $15-20 million. So the recent decline in the Canadian dollar has been a big help. In fact, the loonie's fall was enough to boost net income by $87 million in the fourth quarter alone.

Other metrics were affected by the loonie's fall as well. CN was able to post an operating ratio, which measures operating expenses as a percentage of total revenue (so a lower number is better), of 57.2%. That's well below the industry median of 63.4%. Of course, lower fuel costs have also helped.

That said, we must not get carried away. The decline in the Canadian dollar has primarily been caused by the fall in commodity prices, so CN is still facing more headwinds than it was previously. And the drop in fuel prices not only impacts crude-by-rail volumes, but also helps the trucking industry.

Furthermore, CN Rail manages foreign currency risk primarily by holding U.S. dollar-denominated debt. So when the Canadian dollar declines, this debt burden increases. This can be easy to miss though; any changes in the value of this debt is recorded in “Accumulated Other Comprehensive Loss.” In plain English this means that the debt changes are not included in the net income calculation. Yet shareholders are still impacted.

Should you own the stock?

CN is a great company, but the stock trades at 17 times earnings, which is quite a bit for a company facing so many headwinds. And the earnings number is generally overstated due to the capital-intensive nature of the business.

So even if you’re looking to bet against the Canadian dollar, you’ll probably find better opportunities elsewhere.

CATEGORY

1. Investing

TICKERS GLOBAL

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