Canadian National Railway Company Is Secretly a Great Dividend Stock

Description

There are three things I look for when considering buying a dividend stock: the earnings have to be growing; the company has to be in a defensible position, so it doesn't have to spend large amounts of money fighting off competitors; and finally, the dividend has to be growing.

Canadian National Railway Company (TSX:CNR)(NYSE:CNI) is a company that I believe exemplifies the above three things. On the surface, a 1.8% yield is not all that exciting, but there are a few variables about the yield that make me excited about this company.

Earnings

While its first-quarter 2016 earnings are still a few weeks away, 2015 was an incredible year for the company. Its Q4 2015 net income was $941 million, which was up 11% year over year. Further, this was a 15% increase in diluted earnings per share.

But Canadian National understands there are two ways to grow earnings: increase revenues or decrease costs. While Canadian National saw a 1% drop in revenue, it was able to cut its costs significantly–enough that its income rose 11%.

The reason for this is because of how efficient the railroad is. In 2014, its operation ratio was 60.7%. That's the amount of money it has to spend for every dollar it earns. A year later, it had reduced that to 57.4%. That might not seem like a lot, but when you're talking billions of dollars in revenue, a few percentage points can mean a lot in earnings.

Wide moat

Many investors call a company's defensible position a moat. To launch a competitive railroad would cost tens of billions of dollars; competitors would have to buy the land, build the track, and then launch the railroad. Because of this, I don't expect there to ever be any competition from new companies.

But the moat also has to do with its geographic network. Specifically, it has track that goes all the way from the Pacific to the Atlantic Ocean, as well as south through the United States to the Gulf of Mexico.

No other railroad in North America has this unique network, which puts it in a strong position to continue generating business.

This moat is only going to get stronger as it increases its capacity in Mobile, Alabama. Further, the Port of Prince Rupert, owned by DP World of Dubai, has an exclusive deal with Canadian National. For context, this is the world's fast-growing port, so the moat is only getting stronger.

Growing dividends

Without the above two variables, growing dividends would not be possible. But for Canadian National, growth is abundant. As I mentioned, a 1.8% yield doesn't make many investors excited, but it is growing fast. The company had its initial public offering in 1995. Every year since then, the company has raised its dividend by an average of 17%. In January the company announced that it would be increasing the dividend again by 20% to $0.375.

All told, what you're getting here is a company that is increasing its earnings, is well diversified with a strong and wide moat and, most importantly, has growing dividends that should reward investors for years to come. If you ask me, that is an investment worth having.

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Author
jaycodon