Canadian National Railway Company's Q1 Results Are Out: What Should You Do Now?

Description

Canadian National Railway Company (TSX:CNR)(NYSE:CNI), the largest rail network operator in Canada, released mixed first-quarter earnings results and revised its outlook on fiscal 2016 after the market closed on April 25, and its stock has responded by falling over 5%. Let's break down the quarterly results and its new outlook to determine if we should use this weakness as a long-term buying opportunity or if we should hold off on an investment for the time being.

Breaking it all down

Here's a summary of Canadian National's first-quarter earnings results compared with what analysts had projected and its results in the same period a year ago.

Metric	Q1 2016 Actual	Q1 2016 Expected	Q1 2015 Actual
Earnings Per Share	$1.00	$0.93	$0.86
Revenue	$2.96 billion	$3.09 billion	$3.10 billion

Source: Financial Times

Canadian National's diluted earnings per share increased 16.3% and its revenue decreased 4.3% compared with the first quarter of fiscal 2015. Its double-digit percentage earnings-per-share growth can be attributed to its net income increasing 12.5% to $792 million, which was helped by a $57 million gain on foreign currency translation from its U.S. operations, and its weighted-average number of diluted shares outstanding decreasing 3.1% to 789 million.

The company's slight drop in revenue can be attributed to its total carloads decreasing 7.2% to 1.26 million, primarily due to decreased shipments of energy-related commodities, and this weakness was only partially offset by its total rail freight revenue increasing 2.9% to $2,267 per carload.

Here's a quick breakdown of five other notable statistics from the report compared with the year-ago period:

1. Operating income increased 14.5% to $1.22 billion
2. Operating ratio improved 680 basis points to 58.9%
3. Income before income taxes increased 14.1% to $1.1 billion
4. Net cash provided by operating activities increased 7.4% to $1.07 billion
5. Free cash flow increased 12.1% to $584 million

Other notable announcements

Canadian National also made two important announcements.

First, the company revised its outlook on fiscal 2016. It stated that it "now aims to deliver 2016 EPS in line with last year's adjusted diluted EPS of $4.44," which is down from its previous guidance that called for mid-single-digit percentage growth.

Second, it announced that it would be maintaining its dividend of $0.375 per share in the second quarter, and it will be paid out on June 30 to shareholders of record at the close of business on June 9.

What should you do with Canadian National Railway today?

It was a decent quarter overall for Canadian National given the many headwinds it faced, but its revenue did fall well short of analysts' expectations, and its new outlook is far from impressive, so I think the market has reacted correctly by sending its shares lower. With this being said, I think the decline represents nothing more than a great long-term buying opportunity for three reasons.

First, it's undervalued. Canadian National's stock trades at just 17.3 times its earnings-per-share outlook of $4.44 for fiscal 2016 and only 15 times analysts' estimated earnings per share of $5.14 for fiscal 2017, both of which are inexpensive compared with its five-year average price-to-earnings multiple of 17.7 and the industry average multiple of 21.3. These multiples are also inexpensive given the company's estimated 8.2% long-term earnings growth rate.

Second, the company has been actively repurchasing its common shares. It repurchased 23.3 million shares for $1.75 billion in fiscal 2015 and 7.4 million shares for $520 million in the first quarter of fiscal 2016, and there are 19.8 million shares remaining for repurchase under its normal course issuer bid that began in October 2015 and will end in October 2016.

I think its increased amount of free cash flow will allow it to accelerate repurchases in the second quarter, which will help boost its earnings-per-share growth going forward and make its remaining shares more valuable than ever.

Third, it's a dividend-growth play. Canadian National pays an annual dividend of $1.50 per share, which gives its stock a yield of about 1.95%. A 1.95% yield may not impress you at first, but it is very important for investors to note that the company's 20% dividend hike earlier this year has it on pace for fiscal 2016 to mark the 20th consecutive year in which it has raised its annual dividend payment.

With all of the information provided above in mind, I think all Foolish investors should strongly consider using the post-earnings weakness in Canadian National Railway to begin scaling in to long-term positions.

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1. Dividend Stocks
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