



Why Now Is the Time to Buy Canadian National Railway Company

Description

North American railway stocks remain under considerable pressure because of declining shipments amid weak industrial activity and low commodity prices. This can be primarily attributed to an increasingly volatile economic outlook and the deterioration in the demand for oil, coal, and other key commodities that form a large portion of the bulk goods transported by rail.

As a result, North America's largest railway company **Union Pacific Corporation's** ([NYSE:UNP](#)) share price has plunged 19% over the last year.

Even Canada's railways have not been immune to the downturn.

Canadian National Railway Company's ([TSX:CNR](#))([NYSE:CNI](#)) share price remains relatively flat, while **Canadian Pacific Railway Limited's** ([TSX:CP](#))([NYSE:CP](#)) share price has plunged by a whopping 26%.

Nonetheless, the economic headwinds that are creating this situation can't last forever. The recent decline in stock prices makes now the time for investors to consider adding railway stocks to their portfolios.

Now what?

One of the advantages of investing in railway companies is that the industry possesses an exceptionally wide economic moat because of the strict regulatory requirements and the tremendous amounts of capital required to establish the necessary infrastructure. This helps to protect them from competition and, along with rail being the only cost-effective means to transport bulk freight, virtually guarantees their earnings.

Despite both of Canada's major railway's appearing considerably attractive at this time, I believe that the standout investment opportunity is Canadian National.

Not only does it operate North America's only transcontinental rail network, further reinforcing its economic moat, but it has been consistently more profitable than Canadian Pacific or even Union

Pacific. Over the last 10 years Canadian National has reported an impressive average annual return on equity of 21%, far higher than Canadian Pacific's 16% and Union Pacific's 17%.

Canadian National is also a superior investment because it proportionally derives less of its revenue from coal than other North American railways. This is especially important because coal is caught in an intractable long-term slump.

You see, not only is the outlook for steel-making coal poor (demand for steel from the world's largest consumer, China, continues to fall), but thermal coal is facing a range of secular headwinds that will eventually remove it from the global energy mix. This means that as demand declines, so too will the volumes transported and the revenues that rail companies can earn.

In the case of Canadian National, it only earns 5% of its revenue from coal, whereas Canadian Pacific earns double that figure and Union Pacific earns almost 12%.

Another point worthy of consideration is Canadian National's ongoing focus on controlling costs.

While the protracted slump in crude, which has pushed diesel prices sharply lower, is benefiting the railway industry as a whole, Canadian National was able to cut operating expenses by a greater amount than its peers. For the first quarter 2016 its operating expenses dropped by an impressive 14% compared to Canadian Pacific's 11%, highlighting that it has been able to create far greater operational efficiencies.

This continues to pay dividends for Canadian National through higher margins that can only lead to a healthy bump in its bottom line when the current headwinds subside.

So what?

Canadian National can only be described as one of the best growth stocks available to investors. Not only is it highly profitable and rewarding investors with a handy 1.7% dividend yield, but with rail being the only viable way of transporting a range of bulk goods, demand for its services is unlikely to wane any time soon. This ensures that its earnings will grow once commodities bounce back and there is an upturn in the economy.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:CP (Canadian Pacific Railway)
3. NYSE:UNP (Union Pacific)
4. TSX:CNR (Canadian National Railway Company)
5. TSX:CP (Canadian Pacific Railway)

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