Canadian National Railway Company Is the Best Railroad Stock for You

Description

There is something to be said for acquiring shares in a company that is considered the best in class for its sector. Warren Buffett is known for saying, “it’s better to buy a wonderful company at a fair price than a fair company at a wonderful price.” In my opinion, **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) is just that company.

Unlike other railroads in North America that have been hammered due to slowing economic growth and weak commodities, Canadian National has been able to stay relatively flat, trading between $73 and $78 a share for the past month. Other railroads have seen their stocks lose upwards of 12% of their value due to weak commodities.

So why is Canadian National doing so well?

Because it runs an incredibly efficient railroad. When a company is generating significant revenue, it can sometimes be easy to forget that it is important to keep costs down. Canadian National is a company that never forgets about this fact.

At the end of 2015, its operating ratio–the amount of money it must spend to earn a dollar of revenue–was 58.2%. This is the lowest of all Class I railroads in North America. If that’s not enough, the company was able to reduce its operating ratio by an additional 14% in the first quarter of 2016. Every percentage point that it drops can be tens of millions of dollars in profit that other railroads just can’t keep up with.

Another reason why this railroad has been able to do so well is because it doesn’t derive nearly as much of its revenue from coal. Between a reduction in coal for energy production for environmental reasons and a decrease in metallurgical coal because of a weak economy, railroads that depend on coal shipments are hurting. Unlike its competitors that derive 10-12% revenue from coal, Canadian National only gets 5% of its revenue from coal.

Finally, because of its transcontinental rail network, it is able to ship more goods to more locations without delay. For example, it can ship goods from the Port of Prince Rupert in British Columbia, the world’s fastest-growing port, all the way down to Mobile, Alabama, without ever needing to change trains or cars. That increases speed and decreases costs.

So what do the numbers show?

Year over year, revenue was actually down by about 4% to $2.964 billion, which makes sense because it still does derive some of its earnings from coal. However, the company also posted net income of $792 million, which is up 13% year over year. Further, its operating income was $1.217 billion, up 14% in the same quarter. The reason the company was able to earn more while bringing in less is because of that operating ratio.

Canadian National is wonderful business at a fair price. With a PE of 16.53, you're buying a company that is a little expensive. To soften the blow, it does pay a 2% yield, which comes out to $0.38 per quarter. All in all, Canadian National feels like a buy to me for investors that are thinking very long term.

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1. Investing

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jaycodon