



## Top 5 Takeaways From Canadian National Railway Company's Earnings

### Description

When **Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)) reported its second-quarter numbers on July 25, the headlines were abuzz with the news that the company beat analyst estimates on its bottom line. But as you may know, analyst estimates matter little when it comes to investing, and the headlines failed to tell you why you should add the stock to your watch list if you still haven't. Fret not, for here are the top five highlights from the report that you must know.

#### Key end markets remain weak

Canadian National's revenue slipped 9% year over year in Q2 on 12% lower car-loadings. That isn't really surprising given the persistent weakness in key end markets. Coal was the biggest dampener, with revenue slumping 36% year over year. Meanwhile, lower oil prices hurt shipments of energy-related commodities, sending Canadian National's revenue from metals and petroleum products down about 16-17% each.

The picture looks bleak, but you must also know that Canadian National isn't allowing weak sales to reach its bottom line.

#### Lower revenues but higher margins

In a strong reflection of management efficiency, Canadian National's net income was down only about 3% in Q1 despite the big fall in revenue. While lower traffic and fuel prices helped, due credit should be given to the company for its efforts to improve efficiency, which helped it boost every operating metric in Q2, including train and yard productivity and locomotive utilization.

So despite lower sales, Canadian National improved its operating margin by two percentage points to 45% in Q2. That's even more impressive when you realize that peer **Canadian Pacific Railway Limited's** ([TSX:CP](#))([NYSE:CP](#)) operating margin declined a percentage point to 38% in Q2 despite facing similar business challenges.

#### Operating ratio trends lower

The operating ratio is a key measurement of management efficiency for a railroad. As it measures a company's operating expenses versus its net sales, a lower ratio is always better.

Canadian National is having a tremendous year in this regard. It reported a record second-quarter operating ratio of 54.5%. In sharp contrast, Canadian Pacific's operating ratio increased a percentage point to 62% in its last quarter. In other words, Canadian National is not only improving its operating ratio consistently, but it's also leading the industry with a best-in-class metric.

### **No change in 2016 guidance despite challenges**

Canadian National's second-quarter revenue missed estimates and will likely remain weak through the year as shipments of commodities are projected to be lower compared with 2015.

However, none of that deterred the railroad giant to reiterate its full-year guidance. It still expects to earn flat adjusted earnings of \$4.44 per share in 2016. Note here that the adjusted EPS excluded a deferred tax expense, and Canadian National's reported EPS—which investors should be concerned about—was \$4.39 per share last year.

The point to note is that Canadian National's guidance indirectly speaks about its confidence to lower costs further amid falling revenues. That's definitely a green flag for investors.

### **Capital spending and dividends on track**

Business conditions may have weakened, but Canadian National has its capital-spending targets intact. It plans to invest \$2.75 billion this year with \$1.5 billion going towards infrastructure. At the same time management remains committed to a dividend payout ratio of 35% in the near future, up from 29% currently.

But what really sets Canadian National apart is its strong cash flows. It generated greater free cash flows, both sequentially and year over year, in Q2 despite lower profits. If you've been worried about Canadian National's prospects at all, this should put your worries to rest.

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1. Investing

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1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:CP (Canadian Pacific Railway)
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**Author**  
nehams

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