Why Investing in Railroads Is Good for Your Portfolio

Description

There's always been something intriguing about railroads. Whether it's the sheer number of freight cars a single train can haul, or how efficient railroads have become in getting freight to their destinations, railroads continue to draw admirers.

At first glance, investing in a railroad seems very … retro. In an age when we as consumers look for the next biggest advancement in technology, and, as investors, we look for the biggest opportunity or payout, some might say that the best days for railroad investors have already passed.

So, are railroads really a good investment? Can a railroad investment compete with other businesses vying for spots in your portfolio and provide a steady source of income or long-term growth?

The answer to these questions is a resounding yes for a number of reasons.

Why invest in a railroad?

First, there's efficiency. Rail is the most efficient means of transporting freight, particularly when that freight is in bulk. Shipping, trucking, or even pipeline freight can't compare on a cost and resource level to the efficiency realized in transporting freight by rail.

Freight trains are not only efficient, but they make up a huge part of the economy; as much as 40% of all freight in the U.S. is carried by railroads, including many of the core resources and raw materials needed for businesses.

When the economy is good, railroads are great, and railroads provide an efficient way for materials and products to reach their destinations.

That's not to say that railroads can't strive to become even more efficient. Florida-based **CSX Corporation** (NASDAQ:CSX) just announced that Hunter Harrison will take the reins of the company as CEO. The renowned cost-cutting, efficiency-focused Harrison has already completed spells at both **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) and will likely implement similar cost cuts and efficiency improvements at CSX.

Second, rail networks are massive defensive moats. If you look at the two largest railroads in the country, both Canadian National and Canadian Pacific have sprawling networks that traverse both Canada and the U.S. within reach of nearly every major metro area. Canadian National in particular has access to three different ports — something that no other railroad on the continent can offer.

A new competitor emerging to rival either Canadian Pacific or Canadian National in their respective markets would be a nearly impossible task. Even better, as Canadian Pacific recently learned, is that the defensive moat extends to mergers as well.

After the last series of class one mergers in the 90s, the Surface Transportation Board adopted a strict set of criteria for future mergers. Last year, Canadian Pacific, under the leadership of then CEO Harrison, tried to broker a merger with a competitor that was repeatedly shot down by multiple regulatory bodies, and there's little hope of a revival.

Finally, railroads are performing very well and are forecasting promising growth going forward.

Canadian National provided fourth-quarter results recently; the railroad increased net income by an impressive 8% in the quarter, coming in at $1.02 billion. Operating income also had an uptick of 3% to $1.4 billion, and revenues were up by 2% to $3.22 billion.

In terms of a dividend, Canadian National offers $0.41 per share, which results in a yield of 1.69% at the current stock price. Canadian National currently trades for just under $98 and has a P/E of 20.83.

Canadian Pacific also fared well in its most recent report, posting $1.64 billion in revenue with net income coming in at $384 million. While revenue did drop 3% in the quarter, diluted earnings per share saw a 25% increase in the most recent quarter.

Canadian Pacific's dividend is $0.50 per share, which results in a yield of just 1% at the current stock price. In terms of stock price, Canadian Pacific has appreciated by 168% in the past five years. Canadian Pacific trades at $200 per share with a P/E of 18.86.

In my opinion, an investment in the railroad sector should be a core holding in nearly any portfolio.

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1. Investing

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