Is Canadian National Railway Company Expecting Too Much Economic Growth?

Description

Canadian National Railway Company (TSX:CNR)(NYSE:CNI) is banking on the economy's continued growth, which could prove a dangerous gamble. The railway operator announced that it would be buying 200 locomotives over the next three years from **General Electric Company**.

CN Rail is anticipating continued demand, and by adding these locomotives, the company will be able to improve its efficiency while accommodating greater loads on its tracks.

Earlier this year, CN Rail announced a "hiring spree" to meet the rising demand that it had been witnessing recently. With the TSX reaching record highs and CN Rail experiencing lots of activity on its railways and a very healthy economy, it's hardly a surprise that the company is preparing itself in anticipation of further growth.

Is the company getting too big, too fast?

The Canadian economy has certainly done well in 2017, which has resulted in a few rate hikes this year. There could still be more on the way in 2018. However, rising home prices and debt levels combined with a higher rate of interest could have a net negative impact on the economy next year.

If that happens, we may not see as much growth as CN Rail is banking on to justify these locomotives. There may not be enough activity to keep all of its new workers busy, which could mean some idle time and inefficiency resulting in a softer bottom line.

The company is doubling down on its bet that the economy will keep growing at a time when I'm not sure that's the best bet to make.

Railways are often kept busy by a strong economy

Many of the goods that are transported by rail are consumer products, raw materials, commodities, and other components used by various industries. When railways are busy, it is a good sign that the economy is keeping busy as well.

This is also why I suggested that CN Rail could have a great Q4 after the company announced it was going to hire more workers. However, while staff is easy to cut if the work is not there; it's more difficult to get rid of locomotives that aren't needed anymore, and that's what has me concerned about this purchase.

What does this mean for investors?

CN Rail is seeing a robust economy, and it is certainly projecting that to continue in the near and medium term. In its most recent quarter, the company showed solid top-line growth of 7% year-over-year, and all signs are certainly pointing to Q4 producing another strong result.

After a disappointing 2016 during which sales dropped 5%, CN Rail aims to turn that figure around with its 2017 results. The company has consistently finished north of $12 billion in each of the past three years, posting an equally strong bottom line with profits of at least $3 billion during that period.

CN Rail is a great long-term buy, but I'm not sure my optimism extends to the economy.

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