Should Investors Be Concerned About Canadian National Railway's Q1 Results?

Description

Canadian National Railway (TSX:CNR)(NYSE:CNI) released its quarterly results earlier this week, which failed to impress investors. Despite all the growing demand and the need to bring in more workers, CN Rail's revenues were flat for the quarter, and earnings were down more than 16% from last year. However, the company still came in above estimates, earning adjusted earnings per share (EPS) of $1.

Let's take a closer look behind the results to assess just how good of a quarter CN Rail had.

Rising operating expenses chip away at the company's bottom line

While the company didn't see much movement in its top line, operating expenses were up more than 9% from last year. Labour-related expenses were up $55 million and were responsible for nearly a third of the increase in operating costs. Fuel costs added another $51 million, while purchased services and materials increased by $41 million.

A harsher than normal winter over the past several months has put a strain on the company's operations and led to more inefficiency and higher costs as a result. On the positive side, there were no glaring issues or abnormalities that should have set off alarm bells for investors.

Outlook downgraded

The bigger problem, however, was that the company adjusted its outlook for 2018. Previously, CN Rail was expected to record an adjusted EPS between $5.25 and $5.40, and that has since been reduced to between $5.10 and $5.25. Oftentimes, when we see a company reduce its outlook, it has more of an impact on the share price than its actual performance does, and this could be a big concern for investors, as CN Rail was expecting strong demand and even announced it was going to purchase more locomotives.

If the company's projections were too ambitious, it could lead to a bigger correction in the stock's price.

Company unable to take advantage of competitor's labour problems

Last week, **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP) also released disappointing earnings, and to make matters worse, the company is in the middle of a labour dispute, which could hurt its operations. Unfortunately, for CN Rail, it doesn't even have the capacity to take advantage of any unmet demand. Jean-Jacques Ruest, CEO of CN Rail, stated, "Right now the capacity we have is by and large spoken for, so we wouldn't be much of a factor to be able to pick up the slack if there was going to be a labour disruption."

Although this might be disappointing to CN Rail investors, it's a positive sign that the company is operating near full capacity and suggests that in the coming months' warmer weather might produce some better results for the company.

Is the stock a buy?

In the past year, CN Rail's stock has declined 6%, and it is a decent value buy given that it trades at just 13 times its earnings. However, because of my bearish outlook for the Canadian economy, I'm not optimistic that the railway operator will be able to continue to grow, and these latest results coupled with a downgrade in forecast only confirm those concerns.

Over the long term, CN Rail is a good buy, but there are better stocks on the TSX to invest in today.

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djagielski