Canadian National Railway: A Dividend Stock Ready to Rebound?

Description

For **Canadian National Railway** (TSX:CNR)(NYSE:CNI) stock, 2018 is proving to be one of the toughest years in its recent history.

The company, which operates in an essential duopoly, is struggling to meet the surging demand for freight in North America. Its problems were compounded by a severe winter and the pipeline capacity constraints that forced oil producers to ship their energy products through its rail tracks.

Investors, who were waiting to see how these bottlenecks will hurt the bottom line, got their answer on April 24 when Montreal-based CN Rail announced its first-quarter earnings.

Its profit fell by 16% for the quarter to $741-million, while revenue fell slightly to $3.2-billion. The operating ratio, which compares sales and expenses, rose by six percentage points to 67.8%. On an adjusted basis, earnings per share slipped by 13% to $1 against analysts' expectations of $1.02 a share. The company also cut its profit outlook for 2018 to a range of $5.10 to $5.25, from $5.25 to $5.40.

"Our service has been challenged since the fall. Our results reflect those challenges," said Jean-Jacques Ruest, the interim chief executive officer, on a conference call with analysts.

Higher spending

To counter the congestion in its network, CN Rail plans to spend heavily to improve its capacity. The company raised its 2018 capital expenditure budget 6.3% to a record $3.4 billion. Investments will be concentrated on the western section of the company's network — from the British Columbia ports of Prince Rupert and Vancouver to Chicago, where growth is strongest.

These details, however, were not enough to satisfy investors, who largely remained on the sidelines after the earnings report. CNR stock has shown some strength in the past month after hitting the 52-week low. It's up about 4% and didn't move much after the disappointing earnings.

Despite this dismal outlook, I still think CN Rail is a solid dividend-growth stock that will finally overcome these issues and rebound. Its recent weakness is a good opportunity for income investors to take a long position.

The amount of new spending that the company is spending in its infrastructure will certainly remove the capacity issues in a few quarters. With a wide economic moat and deep pockets, I see CN Rail benefiting from the stronger growth in North America.

To keep things in perspective, CN Rail has delivered excellent returns to investors during the past five years, rising 93% — almost five times more than what's offered by the **S&P/TSX Composite Index**. **Canadian Pacific Railway**, its closest rival, surged 70% during the same period.

The bottom line

Trading at $96.13 a share and the trailing price-to-earnings multiple of 13.28, CNR stock looks cheap to me. That said, I don't think there's room for a quick capital appreciation here until we see the results of higher spending on the bottom line. The stock is a good buy for those who can wait.

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Date
2025/07/04
Date Created
2018/04/28
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