Breaking Down Canadian National Railway's Latest Earnings Report

Description

It's been a difficult 12 months for shareholders of **Canadian National Railway** (TSX:CNR)(NYSE:CNI), as the stock is slightly in the red; meanwhile, peers including **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP), have continued to post solid gains.

But after a review of CN Rail's latest earnings report for the first quarter of 2018, it's not hard to understand why the stock of Canada's largest railway owner and operator has underperformed.

Net income for the first quarter was down 16% compared to the first quarter of 2017, while diluted earnings per share fell 14%, and operating income decreased by 16% for the quarter. A lot of that had to do with rising operating costs, which were 9% higher than the year-ago period. And it didn't help either that while costs were accelerating, revenue was virtually flat, down $12 million over the first quarter of last year.

The result was that CN's operating ratio — a measure by which rails are evaluated for their efficiency — rose six percentage points to 67.8% in Q1.

The last point is particularly concerning, as CN has long prided itself on being an industry-leading operator.

But now it would seem as though CP is closing the gap, and CN needs to shape up or ship out.

To that end, CN's interim president and CEO JJ Ruest said in announcing the disappointing results that the team at CN is "focused on restoring operational and service excellence for all our customers."

Ruest went on to say that the company is seeing improved performance metrics in recent results, and that CN plans to increase its capital program to $3.4 billion with $400 million of that budget being invested in new track infrastructure to help build the company's capacity and track resiliency.

That's the good news.

The bad news is that CN is coming off a quarter where it generated just $322 million in free cash flow compared to $848 million in the year-ago period.

Heavier spending directed towards investments in track infrastructure may pay off for the company over the long term, but, needless to say, the purse strings are going to be tightening at CN for the time being.

Is the dividend in jeopardy?

In short, probably not.

While talk of rising expenses and deteriorating cash flows can naturally give rise to concerns about the safety of the company's $1.82 annual dividend, chances are, there's a lot that would have to go wrong first before CN's board of directors begins to contemplate a dividend cut or suspension.

Bottom line

CN is still a great company and one of the best-managed railroad networks out there.

But 2018 doesn't seem to be a great time to be a CN shareholder, and, as it relates to that dividend, which clocks in at a yield of just 1.69%, surely there are better opportunities out there.

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jphillips