1 Top Infrastructure Stock for Every Portfolio

Description

For the first quarter 2018, North America's fifth largest rail company, **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) reported some disappointing results. The company's latest results, however, demonstrate that it is ready to fire on all cylinders and deliver considerable value for investors over the remainder of 2018 and into 2019. It isn't only organic growth initiatives or the internal focus on driving efficiencies from Canadian National's operations that will be responsible for this but also a range of favourable macro-factors.

Now what?

Canadian National's second quarter net income shot up by an impressive 27% compared to a year earlier, and was a whopping 78% higher than the previous quarter. Notably, free cash flow for the quarter grew by 20% year over year to $974 million, highlighting the strong cash generating capability of Canadian National's operations. Such strong free cash flow growth is a notable positive development because it has significantly bolstered the company's coffers, thereby giving it additional financial flexibility as well as capital to invest in improving its assets and paying down debt.

Those solid results can be attributed to a strong improvement in key performance measures including the volume of carloads, which rose by 6% year over year and a 7% expansion in revenue ton miles (RTMs).

Notably, rail freight revenue per carload – a key indicator of earnings performance – grew by 4% compared to a year earlier. This robust performance was driven by a noticeable increase in the volume of bulk freight transported during the quarter, with the largest increase being coal, where the number of carloads increased by 21% year over year for that commodity alone. The volume of petroleum, metals and grain also all grew markedly rising by 4%, 8% and 9%, respectively.

It is easy to see Canadian National reporting further strong results over the remainder of 2018 and into 2019. This is because the global economic upswing is gaining momentum despite the threats posed by Trump's approach to trade. And that, along with Beijing's planned economic stimulus, will drive greater demand for commodities, particularly coal, base metals and oil. Because rail is the only economically viable means of transporting large volumes of bulk freight like coal, grains and metals, Canadian National should see the volume of carloads for those items grow.

Domestic pipeline constraints, which are primarily responsible for the deep-discount applied to Canadian heavy oil coupled with rising production in the energy patch and higher domestic oil inventories will lead to greater crude by rail.

In fact, at the height of the last oil boom in 2013, crude by rail was touted as the interim solution to resolving the transportation woes created by inadequate pipeline capacity. That saw a surge in the volume of oil being transported by Canadian National and **Canadian Pacific Railway Ltd.** Rising oil prices and production will trigger the same phenomenon over coming months, particularly with many oil sands producers boosting output and pushing to get their oil to key U.S. Gulf Coast refining markets.

You see, Canada's heavy oil including bitumen and other heavy blends are important feedstock for refineries configured for heavy oil, which are located on the U.S. Gulf Coast. The sharp deterioration in Venezuelan oil production, which is predominantly heavy crude that is exported to the U.S., has created greater demand for Canadian heavy blends. Because of existing domestic pipeline constraints, the only way that can be met is by ramping up crude by rail.

Canadian National is well positioned to benefit from this trend because it is the only rail operator in North America with a truly transnational network that stretches from the heart of the oil sands in Alberta to the U.S. Gulf Coast.

So what?

Canadian National is well positioned to benefit from firmer economic growth and expanding domestic oil production, which will spark greater demand for bulk freight transport. And that, along with the company's focus on cost control and strategy to drive greater efficiencies from its operations, will boost profitability and give its bottom line a healthy lift. It will also enhance the sustainability of Canadian National's dividend and lead to additional dividend hikes. While its dividend only yields a modest 1.5%, the company has a long history of growing its dividend, having hiked it for the last 22-years.

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Date
2025/08/15
Date Created
2018/08/13
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