The Evolving Opportunity in Railroad Investments

Description

The stereotypical view of railroads among investors is that they are old, low-tech relics from the last century that have little impact on the market and are not evolving with the changing trends in technology. **Canadian National Railway** (TSX:CNR)(NYSE:CNI) is often the target of those criticisms, which, unfortunately, masks what is an incredible opportunity for investors.

Let's try to dispel those myths and highlight the opportunity for investors.

Railroads are old relics

A common fallacy among investors is that railroads are low-tech remnants of the 19th and 20th centuries. While it is true that railroads were originally developed and built well over a century ago, this provides an advantage, not a disadvantage to the 21st-century investor.

When railroad networks were built to connect factories and distribution centres, few people realized that the cities and communities that developed around those railroads would create an incredible moat. In fact, the development of those communities has made it nearly cost prohibitive for new railroad networks to emerge. Following a series of mergers in the 90s, a strict set of criteria were adopted to discourage, if not prevent, further consolidation in the marketplace.

This has worked out well for Canadian National, which is the only railroad on the continent with access to three coastlines on a sprawling network of over 30,000 kilometres.

That's not to say that railroads can't grow — Canadian National recently submitted a bid to acquire part of the Halterm container terminal in Halifax. Halifax is the fourth-busiest port by container traffic, behind only Vancouver, Montreal, and, most importantly, Prince Rupert, where Canadian National already has a large presence.

The northern B.C. port that Canadian National serves has proved to be of particular success, and experts think this latest approach in Halifax has put Canadian National down the path of establishing a similar success story on the east coast.

Railroads are low tech

As for the low-tech myth, let’s talk about oil for a moment.

Canadian National and other railroads can haul oil and chemicals. These are incredibly fragile and volatile products to ship, as shifts in massive amounts of liquids, even at low speeds, could quickly become a derailment and ecological disaster, not to mention render the track offline for a considerable amount of time.

Fortunately, Canadian National is working on a revolutionary new process that converts oil into a dry product that is coated in a polymer that allows it to be shipped safely and quickly like any other material. Upon arrival, the polymer is removed and the solid product can be refined.

Once this process becomes common use, the potential opportunity for Canadian National will be huge. Unfortunately, the technology is still a few years out, but there’s no reason for investors to pass on the stock until that time.

Railroads have little impact on the market

In many ways, railroad networks are viewed as arterial veins of the economy.

Railroads haul an incredible amount of freight that is vital to the market. In terms of freight, railroads haul everything from automotive components and raw materials to crude oil and crops, which currently amounts to nearly $250 billion worth of goods every year.

That’s an incredible number of goods, and the absence of that rail network could prove disastrous.

A glimmer of that very point came about last year as a harsh and long winter caused system-wide delays last February, resulting in a domino effect on the economy, as plants remained without parts, farmers were left waiting for trains to pick up their goods, and refineries operated on lower capacities.

Final thoughts

Railroads are great investments. The recurring revenue and necessity that they provide to our modern society are without dispute, and growth-seeking investors will appreciate the opportunity that the current pullback in the market has provided.

From an income standpoint, Canadian National offers a quarterly dividend that pays a yield of 1.83%, which, while not the best return on the market, is a respectable return from a stable segment.

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Date
2025/08/18
Date Created
2018/12/24
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