Canadian National Railway (TSX:CNR): Is This Stock Becoming Expensive?

Description

The Canadian National Railway Co. (TSX:CNR)(NYSE:CNI) has had a powerful rally this year. Its stock has surged more than 20%, outpacing the **S&P/TSX Composite Index** gains during the same period. But after this strength, investors are wondering whether there's more upside ahead.

Amid an environment when the headwinds for growth stocks are gathering pace, the company is becoming increasingly relevant. The U.S.-China trade war has direct implications for the transport and logistical companies, such as CN Rail. There are also indications that the North American economy is hitting a slow patch after the robust growth of the past many years.

The Bank of Canada is already on the sidelines, while the U.S. Federal Reserve this week warned that its next move could be a rate cut if the economy shows more weakness. CN Rail can't remain immune to these developments due to its crucial role in the economy.

The company runs a 20,000-mile network that spans Canada and mid-America, connecting three coasts: the Atlantic, the Pacific and the Gulf of Mexico. There is hardly any product that we consume in Canada that CN Rail network doesn't handle. It transports more than $250 billion worth of goods annually, ranging from commodities to consumer goods.

Looking at the latest financial data, it seems that the company is vulnerable to a sudden change in the economic direction. In the company's latest quarterly report, CN reported weaker-than-expected profit.

During the quarter, operating expenses rose 14% due to a crude oil train derailment in Western Canada. CN Rail growth is also being hurt due to Alberta's OPEC-style decision to force production cuts to deal with a glut. As a result, demand for crude shipment fell in February, the company said.

The company's operating ratio, a key performance indicator, came in at 67.2%, which is also lower than the analyst's projection of 64.1%. Highlighting some of these risks, **RBC Dominion Securities** analyst Walter Spracklin has recently downgraded CN Rail stock, pointing out to the company's historically high valuation.

With these cyclical headwinds, however, CN Rail has a strong ability to rebound once the skies clear. Over the past two years, the company has invested massively to improve its handling capacity by buying more rail cars and adding other physical infrastructure. CNR's steadily growing dividend is another reason to remain invested in its stock, as it provides a big incentive to ride through the market volatility.

Bottom line

Trading at $122.52 at writing, CNR stock is close to its consensus price target with its valuations looking a bit stretched. If you're on the sidelines, it's better to wait for a better entry point. But if you already hold this stock, I don't see any reason to exit this trade, as there aren't many stocks with such a big competitive advantage and market power.

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