Should You Buy CN Rail (TSX:CNR) After its Q2 Beat?

Description

CN Rail (TSX:CNR)(NYSE:CNI) clocked in an earnings beat to go with an improved operating ratio on Wednesday, sparking shares to bounce over 3% in the subsequent trading session. The impressive bottom-line beat was commendable, but it was the improved operating ratio that had me most excited.

An efficient quarter indeed

The railway posted a solid 57.5% operating ratio, an improvement of 70 bps on a year-over-year basis, further solidifying CN Rail's position as North America's most efficient railway. TransX was a slight drag on efficiencies, but nevertheless, the railway managed to improve its operating ratio by a meaningful amount.

Forest products aside, carloads increased across the board, particularly with petroleum and chemicals. Hats off to management who saw the increase and reacted in an abrupt fashion without compromising too much on the efficiency front.

Car velocity was up 9% year over year thanks to prior infrastructure investments with fuel efficiency also improving by 2% year over year.

Looking ahead, management sees U.S. volumes to really pick up in the latter part of the year, and with track expansion efforts slated to finish in the third quarter, CN Rail looks ready for the increased business.

Should you buy now?

Several analysts upgraded the name across the board, and although there may be little, if any, room to improve upon its industry-leading operating ratio in the second half, I think the management team led by CEO J.J. Ruest has the ability to surprise us again on the efficiency front.

With low double-digit EPS numbers now expected for the year, I think the stock is fairly valued at around 20 times next year's expected earnings.

That said, Ruest and company seemed cautiously optimistic about guiding for the second half and given the firm's somewhat conservative guidance track record, I'd say there's still considerable upside, even at today's slightly expensive levels.

Although CN Rail isn't a bargain after the 3% post-earnings bounce, I think it's an appropriate time to initiate a position if you're looking for long-term capital appreciation and dividend growth. In this market, you've got to pay a premium for quality, and few other firms are able to stack up against CN Rail in this category.

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Author
joefrenette