Is Canadian National Railway (TSX:CNR) Still a Buy With a Looming Recession?

Description

Earlier this month, **The Canadian National Railway** (TSX:CNR)(NYSE:CNI) released earnings that fell short of the company's 2019 guidance. While CN had forecast earnings growth in the low double-digit range, actual growth in earnings per share came in at 8% year over year.

CN stock actually rose shortly after the news was announced. Prior to the earnings release, CFO Ghislain Houle made a public statement saying that the company's revenue ton miles (RTMs) had flatlined, thanks to a softening economy and trade tensions. The statement sent the stock tanking, as investors expected worse than the lukewarm third-quarter results they later received.

Nevertheless, with many economists calling for a recession, the nation's biggest railway could be in for some headaches. Before looking into that, let's take a closer look at the railway's recent results.

CN's recent earnings

CN's recent results showed modest overall growth, but declining revenue in some key business areas.

Overall, revenue was up 4% and earnings up 8% (11% on an adjusted basis). Operating income increased by 8%, and the operating ratio improved by 1.6 points to 57.9%.

These results are all improvements over the same quarter a year before. However, the railroad's performance was weaker in the second half of Q3 than in the first half. Results on its website for week 42 show a 12% decrease year over year, which would likely translate to lower revenue. Additionally, the company posted revenue declines in a few key business areas like coal and lumber. If these results persist in to the winter, then the next quarter will likely be worse than the most recent one.

Why recessions are bad for railways

Recessions are bad for most industries, but they affect railways more than the average business. The reason is that railway earnings are intimately tied to economic growth.

Railways generally transport raw commodities like metals, petrochemicals, and grain. Demand for these commodities tends to decrease during recessions, resulting in fewer shipments. As a natural result, railways tend to see particularly severe revenue declines during recessions.

On the bright side, rail is one type of infrastructure that lends itself well to automation, so earnings may increase even in times of falling revenue. However, that's far from guaranteed.

Foolish takeaway

Most likely, if North America went into a recession, CN would be adversely affected. As a transportation company, it's simply too closely tied to the macroeconomic environment to not be.

However, there's a bright side to all this: the economy always recovers after it takes a downturn, and expansions last longer than contractions.

Although CN is facing headwinds related to economic growth right now, these conditions won't last forever. When they pass, the railway may be able to return to its target low double-digit earnings growth.

In addition, it's worth pointing out that we're not yet in an official recession, just a minor slowdown. Some economic metrics, like employment levels and productivity, are actually very strong at the moment.

Nobody knows exactly what the future holds. However, the past 20 years have shown that CN is more than capable of surviving recessions and coming back stronger than ever.

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