Buy Canadian National Railway (TSX:CNR): Canada’s Top Dividend-Growth Stock

Description

The Fed’s latest interest rate cut at the end of last month coupled with the increasing likelihood of an end to the U.S.-China trade war have triggered considerable optimism that a global recession can be avoided. This has given stocks a healthy boost, seeing the TSX hit a record high and be up by a notable 18% for the year to date. The improved outlook bodes well for stocks such as **Canadian National Railway** (TSX:CNR)(NYSE:CNI), which has gained a handy 23% compared to 30% for **Canadian Pacific**. This has created an opportunity to acquire one of Canada’s top Dividend Aristocrats at an attractive valuation.

Improved outlook

A key driver of earnings growth for Canadian National will be the recent rebound in commodities, which has seen crude rally sharply and base metals surge. Oil has gained 25% since the start of 2019, while zinc, lead, and nickel have all gained 1%, 3.5%, and 46%, respectively. This is especially beneficial for Canadian National, because rail remains the only low-risk and economic means of transporting bulk freight.

Oil and chemicals for the third quarter were responsible for generating 22% of the company’s rail freight revenue, and a further 16% came from metals and minerals, including coal, highlighting just how important commodities are for Canadian National’s earnings. Higher oil and metals prices will drive greater production, leading to increased demand for the company’s transportation services.

The lack of pipeline exit capacity is also a boon for Canadian National, because crude by rail remains the only effective means of addressing the transportation constraints created by the energy patch’s dependence on a limited number of pipelines to access crucial U.S. energy markets.

If the trade war is resolved and consumption picks up, particularly south of the border, then it will remove considerable pressure from China’s waning economy and will stimulate its manufacturing sector. That will lead to greater demand for raw materials, because China, which is known as the world's workshop, possesses the largest manufacturing sector globally.

Not only will that see Canadian National benefit from greater commodity demand but also give transportation volumes for its intermodal business a healthy lift. Intermodal was responsible for generating 28% of Canadian National's third-quarter revenue, illustrating just how important it is to drive earnings growth.

Canadian National is focused on reducing costs and driving greater productivity from its business to boost profitability. The company is achieving this by divesting itself of aging or unessential rolling stocks, returning all leased locomotives and the more efficient use of fuel. That saw total third-quarter operating expenses remain roughly flat compared to a year earlier, while fuel expenses fell by 11%, labour costs dropped by 2%, and equipment rents decreased by 10%. For the third quarter, Canadian National's net income expanded by a healthy 5% year over year, and, for the reasons discussed, this will continue for the foreseeable future.

Foolish takeaway

Canadian National's wide economic moat is supported by steep barriers to entry for the industry, its continent-wide rail network, and relative inelastic demand for its services. That makes it the ideal defensive stock, particularly when its long history of dividend hikes is considered. Canadian National has increased its dividend for 23 years straight to yield 1.7%.

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