Why Canadian National Railway (TSX:CNR) Surprised the Market Yesterday

Description

Canadian National Railway Co. (TSX:CNR)(NYSE:CNR) surprised the market yesterday with a better than expected second quarter report. This morning the stock is rallying to new all-time highs as a result. This is in the face of a global pandemic that is crippling many industries. How can we explain Canadian National Railway's stock price performance?

We can start to make sense of this by analyzing its company-specific performance. Canadian National Railway's earnings result gave the market many positive surprises yesterday. We are getting an increasingly clear picture of the operational excellence of CN Rail.

Canadian National Railway has embarked on a journey of cost efficiency. This began many years ago. But today, the market continues to be surprised at just how low the company can go.

Canadian National Railway continues to drive fuel efficiency

CN Rail's goal of reducing its carbon footprint is a timely one. It is a goal that has long-term as well as short-term merit. It reduces the company's costs, decreases its environmental impact, and raises the value of the company.

In the second quarter, Canadian National Railway's fuel efficiency gained more ground. In fact, it is in record territory. The company recorded fuel efficiency of 0.88 gallons of locomotive fuel consumed per 1,000 gross ton miles. This is an 8% improvement, as train weight and train lengths reached historic levels. It means the company moves 8% more tonnage the same distance with the same amount of fuel.

Canadian National Railway makes structural improvements for long-term success

Fuel efficiency improvements are just the beginning. CN Rail has also been working on structural improvements that are driving value. During this time of low demand and reduced activity, the company has been working hard.

Structural improvements and modernizations are driving costs down and improving performance. For instance, the idled locomotive shops and switching yards will remain closed. Also, the company is in the process of digitizing many functions, setting the railway up well today and well into the future.

CN Rail is increasing its use of technology. Virtual training, automated track inspection, and automated inspection portals are being set up, lowering costs and improve performance and productivity. Productivity has already improved up to 25% because of structural improvements made, while activity was lower.

Canadian National Railway stock will be supported as activity and demand slowly returns

According to management, the trough in volumes happened in late May. Despite this, there were pockets of strength. Grain and coal saw record demand, and CN is therefore expanding in this segment by adding 500 high capacity cars. Propane volumes also hit a record, driven by AltaGas' Ridley terminal.

Today, Canadian National Railway is seeing an uptick in demand for diesel, and ethanol. The company is expecting sequential growth in the third quarter. The consumer business has been resilient and is expected to see growth going forward.

The automotive sector is also coming back after falling 90% in May. Automotive plants are in production in what would be their summer shutdown.

Foolish final thoughts

In closing, I would like to highlight Canadian National Railway's resiliency. This has been shown once again in Canadian National Railway's earnings result. These are extremely difficult times.

Yet, CN Rail managed to generate $1 billion in free cash flow in the second quarter and $1.6 billion year-to-date. As such, the dividend and capital expenditure plans have been reaffirmed.

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