Why CN Rail Stock Is Still a Good Buy Today

Description

It's tempting to take one look at the economy right now and want to crawl into a cave. Investors might even be thinking of getting out of equities altogether. But there is one stock that not only accurately reflects the economy but also manages to appeal as an investment.

Today we will take a quick overview of **CN Rail**'s (TSX:CNR)(NYSE:CNI) terrible second-quarter and why its stock is still a buy.

A de facto play on the Canadian economy

It should come as no great surprise to investors that 2020's second quarter was one of the worst on record. The March selloff was truly one for the history books, followed by oil's soundest thrashing to date. Demand for industrials was meagre, while entire sectors – that are only now peeking above the parapet – were entirely shuttered. As a mirror for the economy, CN Rail's matching losses (down in energy, up in grain) during this period are especially illuminating.

Meanwhile, CN Rail has been raising liquidity by selling non-core assets. Although this is logically a cost reduction method that has its limits, it shows the CN Rail is stress-proofing. Additionally, given the shock-and-awe nature of the pandemic, the financial second quarter is likely to have been an economic low point.

Demand is therefore expected to pick up for the second half of 2020, bringing the expectation that CN Rail's operating ratio will fall accordingly.

A resilient stock, but with near-term stressors

Strikes. Negative oil prices. Protests. Blockades. The pandemic. It's been a rough 12 months for Canadian rail operators. But both big names have seen their share prices increase during that period. And despite seeing share price gains in 12 months of 8.6%, CN Rail is still attractively valued. With a 1.8% yield on offer, CN Rail is a richer-yielding pick than rival **Canadian Pacific**.

There are still issues to weigh up before buying shares in either rail operator, though. Granted, CP might look the better performing stock at the moment (notably, CP has managed to reduce its operating ratio during the second quarter, while CN Rail's has gone up). But both operators have cut costs through means that may prove untenable in the longer-term.

Increasing weights and lengths of trains is undoubtedly a canny move. But whether this is sustainable is another matter. A bearish observer might point out that trains can only be laden and lengthened by so much.

Additionally, some of that cost cutting is staff-based – another metric that can only be squeezed by so much. Cost control is finite, in other words. However, a decline in sales might not be.

However, it looks as though the worst is behind both rail operators. Calling 2020's Q2 the "toughest quarter of his career," CN Rail CEO Jean-Jacques Ruest heads a company now laser-focused on cost-cutting.

But since freight demand likely hit its nadir two months ago, improvements should be forthcoming. Going forward, a recovery should bring some dependable upside for investors.

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