Why CN Rail (TSX:CNR) Stock Is Just Getting Started

Description

CN Rail (TSX:CNR)(NYSE:CNI) has been crushing the **TSX Index** over the last few months amid the broader railway rally. Although shares are a tad of the pricey side based on traditional valuation metrics, I think the railway was actually undervalued given the fact that the company would play a major role in lifting the economy out of its funk.

Moreover, I've commented on the firm's resilience in the face of crises, noting that CNR stock would likely hold its own if another round of COVID-induced shutdowns were to cause a repeat of the economic disaster that happened back in February and March.

CN Rail: Resilience in the face of a crisis

"The company, led by J.J. Ruest, also has room to improve upon its operating margin, and headwinds gradually fade; I think CN Rail stock will be unstoppable moving out of this crisis," I said in a prior piece, referring to CN Rail as a vital backbone of the North American economy.

"Even if this pandemic were to drag on for longer than expected, CN Rail is in a position of tremendous resilience. The company didn't implode to the same extent as most other companies in the Great Financial Crisis, and the same is likely in this public health crisis thanks to brilliant risk-mitigating managers and sky-high barriers to entry that will protect the firm's long-term economic profits."

As a Dividend Aristocrat that's able to hold its own during market crashes, CN Rail deserves every bit of its premium multiple, especially given CN Rail has the infrastructure in place to deal with abruptly increasing carloads and signs that the bottom may have been put in back in May.

Pricey metrics. Undervalued stock

At the time of writing, shares of CN Rail trade at 16.7 times EV/EBITDA, 7.1 times sales, 16.2 times cash flow, and 5.3 times book value, all of which are considerably higher than CNR stock's five-year historical average multiples of 12.6, 5.8, 14.1, and 4.7, respectively. Based on such metrics, CN Rail is the priciest it's been in a decade, but given the growth on the horizon, I'd argue that such valuation metrics don't tell the full story.

CN Rail holds the title of North America's most efficient railway, and for a good reason. The company has been able to improve its businesses, even in times of turmoil. Over the last five years, CN Rail has averaged an astounding 17% return on invested capital (ROIC). With stellar operating margins that could surge in conjunction with revenues over the next two years of recovery, I wouldn't at all be surprised to see shares of CNR hit the $160 mark by year's end.

Foolish takeaway on CN Rail

Management's disciplined efficiency focus will pay dividends. As the operating ratio looks to improve in a big way next year (possibly below the midcycle levels of around 57%), CN Rail could easily find itself as the leader on the back of the next bull market.

For now, the company will continue rolling with the punches thrown its way by this crisis. With exceptional risk mitigators running the show, I expect the stock will be tough to stop, as it builds upon its operating performance coming out of this crisis. I view CN Rail as one of the lowest-risk recovery plays on the market and am considering adding to my already sizable position on any meaningful pullback.

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