CN Rail Just Plunged 6.1% — Should You Buy the Dip?

Description

Don't look now, but **CN Rail** (TSX:CNR)(NYSE:CNI) is under pressure following the release of its third-quarter earnings that missed the mark by a landslide, causing many analysts to slash their price targets. While the Q3 miss was weighed down heavily by the coronavirus disease 2019 (COVID-19) impact for the quarter, I do think the 6.1% post-earnings flop was a tad overblown, as there were some bright spots, which, while unable to offset the negatives, were still noteworthy.

Was the third-quarter miss just a bump in the road?

There's no question that the downside surprise caused many investors to sell first with the intention of asking questions later. While there was weakness across the board, I don't think the medium-term recovery trajectory is in jeopardy. In fact, there were some promising signs that a big 2021 recovery is underway. But first, let's have a look at the negatives that the Street was most focused on in Wednesday's choppy trading session.

A lot of hair on CN Rail's third quarter

CN Rail clocked in Q3 EPS of $1.38, falling below the consensus estimate of $1.46. Revenue plunged 11% year-over-year to $3.4 billion, as volumes contracted by 7%. And to add a sprinkle of salt to the lacklustre quarter, the operating ratio (lower is better), which measures operational efficiency, jumped 200b basis points to nearly 60%.

CN Rail is known as North America's most efficient railway. Given the trajectory of the operating trajectory, one would think that the firm is at risk of surrendering the title to the likes of a **CP Rail**. CN CEO J.J. Ruest seemed unshaken by the increased operating ratio in an interview conducted by *BNN Bloomberg.* And he really has no reason to be, as CN Rail still looks in great shape to regain the throne next year, as it does its part to lift the Canadian economy out of its funk.

There were some positives.

The company did a pretty decent job of keeping its operating expenses in check. For the quarter, operating expenses fell 8% year-over-year thanks in part to record fuel efficiencies. Train length was up 6% year over year, allowing for a modest reduction in the average headcount.

Had it not been for management's stellar cost controls, the quarter could have been far worse. CN's management reframed from offering guidance due to the tremendous amount of uncertainties but expects to reinstate guidance once January rolls around.

CN Rail's valuation is still anything but cheap!

After the big post-earnings plunge, CN Rail still sports a pretty lofty valuation. At the time of writing, CNR stock trades at 27.3 times trailing earnings, 7.4 times sales, and 20.7 times cash flow, making it one of the pricier railway stocks out there.

Near-term investor expectations may have gotten out of hand as the stock surged to record highs going into the quarter. With a strong recovery likely coming over the next year, CN Rail stock deserves every penny of its premium price tag and would encourage investors to load up on shares after the 6.1% drop, as I think the quarter wasn't as bad as investors and analysts are making it out to be.

Foolish takeaway on CN Rail stock

The medium- to long-term fundamentals look unchanged after the tough quarter. I think Q3 should be seen as nothing more than a bump in the road en route to much higher levels. Nobody said CN Rail's recovery would be a smooth one. If you're willing to put up with the volatility that lies ahead, I'd look to buy the dip before volumes (and CN Rail stock) really have a chance to really take-off.

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