CN Railway (TSX:CNR): I Might Book Gains in This Stock

Description

Canadian National Railway (TSX:CNR)(NYSE:CNI) is the longest-standing stock in my current portfolio. I've owned it since early 2018 and have earned decent gains on it since buying. The stock made it through the COVID-19 pandemic without as much as a scratch, having been an "essential service" in 2020. Incidentally, the company actually did see its revenues and earnings decline in the wake of COVID-19, but its stock rose anyway. Perhaps investors thought that the company's strong competitive position made it valuable as a long-term bet on the economy.

In any case, CNR did well in 2020 and 2021 — so much so that I'm now considering booking gains. At this point, CN stock is far from a value play, and I think I may be able to invest the money I have in it better elsewhere. In this article, I'll explain why that's the case.

Recent earnings were pretty strong

Before going any further, I should say that CNR's most recent earnings release was pretty good. In it, the company posted

- $3.75 billion in revenue, up 3%;
- $1.5 billion in operating income, up 11%;
- $1.69 in GAAP EPS, up 18%; and
- $1.71 in adjusted EPS, up 20%.

Those are pretty strong metrics overall. It should be noticed that they were delivered a year after 2020, when COVID-19 was holding back CNR's revenue. That tempers my enthusiasm somewhat. Still, CNR is basically a growing, profitable company. It has an enviable competitive position as well. It's the only major North American railway that touches on three coasts, which gives it a big edge in certain shipping routes. With CN, North American companies can transport goods in bulk to all kinds of different places. Thanks to this advantage, CN has the privilege of moving $250 billion worth of goods each year — and growing!

Two reason I'm losing interest

As we've seen, CNR is a "moat" stock that just recently put out decent earnings. It certainly looks like a winner. Why, then, am I losing interest?

It comes down to two things.

First, railroads are normally considered value plays. They offer "slow and steady" growth but at very little risk. Railroads are very capital intensive, requiring billions per year to run, so the rail giants don't exactly face a mountain of competition from new entrants. This practically guarantees modest growth for railroads as long as GDP grows over time. So, railroads are classic defensive value plays. The problem with CNR is that it's not actually that cheap. Trading at 26 times earnings and seven times sales, it's as expensive as some of the big tech stocks. Next to that, you have bank stocks, which usually trade at 12 or 13 times earnings and have growth prospects similar to CN's. I consider the latter sector a better value.

Second, CN's management has been making some questionable decisions. Recently, CNR's executives offered $31 billion to **Kansas City Southern** for a takeover. The deal implied a steep valuation for Kansas City Southern, which hasn't exactly been delivering explosive growth lately. This all came after **Canadian Pacific** bid $25 billion for KSU. It looks like CN got into a bidding war with its biggest competitor and ended up offering more than the prize was worth. This behaviour isn't a hallmark of sober judgment in mind. So, my conviction in CNR is lower than it was in the past.

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