Should You Hold Canadian National Railway in Your TFSA?

Description

The Tax-Free Savings Account, or TFSA, is a popular registered account in Canada. Introduced in 2009, the TFSA is a tax-sheltered account, which means any income generated in one will be exempt from Canada Revenue Agency taxes.

So, investors can generate income via capital gains, interests, and dividends in their TFSA but don't have to pay a single penny to the CRA. Given these features, it makes sense to hold blue-chip dividend stocks in your TFSA, as you can benefit from long-term capital gains and regular dividend payments.

One such blue-chip stock trading on the TSX is **Canadian National Railway** (TSX:CNR)(NYSE:CNI), which has returned 246% to investors since September 2012. After adjusting for dividends, total returns are closer to 310%. Comparatively, the S&P 500 has surged 239% in this period.

But past returns do not guarantee future gains. We need to see if it makes sense to add CNR stock to your TFSA portfolio right now.

Canadian National Railway is a TSX giant

Valued at a market cap of $109 billion and an enterprise value of $123.4 billion, Canadian National Railway is among the largest companies in Canada. A transportation leader and trade enabler which is essential to the economy, Canadian National Railway transports 300 tons of natural resources, manufactured products, and finished goods in North America each year.

It is the only railroad that connects Canada's coastlines with the United States through a rail network that spans 18,600 miles.

Moreover, CNR has successfully delivered valuable transportation services in North America, and its freight revenues are derived from seven commodity groups, indicating a balanced and diversified portfolio of goods.

Canadian National Railway is thus well poised to weather economic downturns and enhance its potential for growth opportunities once the economy recovers.

In the second quarter (Q2) of 2022, CNR reported revenue of $4.34 billion, an increase of 21% year over year. Its adjusted earnings per share surged 30% to $1.93 in the June quarter. Despite a challenging macro environment, the company delivered solid results, showcasing its robust business model and pricing power.

Canadian National Railway confirmed that its performance in Q2 was driven by improvements in several metrics, such as origin train performance, car velocity, and record fuel efficiency, which resulted in a lower operating ratio.

In 2022, Canadian National Railway expects adjusted earnings to grow between 15% and 20%. It is targeting an operating ratio of 60% for the year and a return on invested capital of 15%. Further, the transportation giant estimates free cash flow between $3.7 billion and $4 billion in 2022.

Is CNR stock overvalued or undervalued?

Bay Street expects Canadian National Railway to increase sales by 15.7% to $16.75 billion in 2022 and adjusted earnings by 20% to $7.14 per share in 2022. So, CNR stock is valued at 6.6 times forward sales and 21.8 times forward earnings, which is reasonable.

Canadian National Railway is forecast to increase adjusted earnings at an annual rate of 15% in the next five years. Further, it pays investors an annual dividend of $2.93 per share, indicating a forward yield of 1.8%. These payouts have increased at an annual rate of 12% in the last five years.

CNR's earnings expansion and rising dividend payouts should drive its stock price higher over the long term.

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