The Cargo Segment of the Transportation Sector Has Been Soaring Since March: Is it Too Late to Buy?

Description

The pandemic has changed consumption and shopping trends around the world. One of the most discussed changes is the acceleration of e-commerce. E-commerce stocks like **Shopify** have surged to all-time highs on the back of this trend.

Cargo-focussed transportation stocks have also surpassed their pre-pandemic prices in many cases. This has many investors likely asking whether it is too late to capitalize on the trend of rising cargo volumes. This requires answering a few basic questions first.

What type of cargo volumes are you trying to gain exposure to?

Canadian National Railway (TSX:CNR)(NYSE:CNI), for example, benefits from an increase in low-value cargo volumes. When dealing with high-volume, low-value cargo, trains are the most cost-effective option. It doesn't make sense to load tonnes of wheat, which only costs a few hundred dollars per tonne, into airplanes to fly it across the country. There is simply too much wheat that needs to be moved for this method of transportation to be economical.

Therefore, CN significantly benefits from increases in the movement of commodities across the country. CN's stock price has recovered to pre-pandemic levels, as the volume of commodities being moved by rail has remained relatively high, except for oil. However, CN has not enjoyed the sharp share price spike that Shopify or cargo-focussed airlines have.

CN also has a very high-moat business model and pays a modest, but growing, dividend. Therefore, the stock is a great pick for long-term investors. However, don't expect it to benefit as much as some other companies will, or have, from the rise in e-commerce.

Do you want a pure-play cargo company?

We will explore the concept of a pure-play cargo transportation company from the perspective of airlines. In this case, **Cargojet** (TSX:CJT) is a pure-play cargo airline stock. The company's shares have more than doubled in price since March. This is directly attributable to the rising cargo volumes that have come with increased e-commerce.

Cargo-focussed airlines benefit significantly from e-commerce cargo volumes, because these are often low-volume and high-value items. The additional cost of transporting these goods by air, instead of by train or truck, is worth it. The additional cost of shipping is worth it, because it is easier to absorb the higher shipping costs when the prices and profit margins of the goods are higher.

A large part of Cargojet's recent success is due to the complete lack of a passenger division. This has been a lifesaver for Cargojet in 2020. However, if transportation trends revert to their pre-pandemic ways, there will be a sharp increase in passenger volumes and a decrease, or at least levelling off, of cargo volumes. This could prove to be a difficult environment for Cargojet and the company's shareholders.

Diversified exposure provides a hedge

Air Canada (TSX:AC) has struggled because of the pandemic. The airline's Q2 revenue was down approximately 90% compared to Q2 2019. Unfortunately, being a passenger airline in 2020 has been difficult. However, Air Canada's cargo division reported a 51% increase in revenue compared to Q2 2019. Surprisingly, Air Canada generated more revenue from the cargo division than it did from the passenger division in Q2 2020.

Air Canada provides some exposure to the cargo market, without leaving investors too exposed if cargo volumes drop, as passenger volumes pick back up. The company's share price has been punished in 2020 and has come nowhere close to pre-pandemic levels yet. This may make it a good buy at current levels.

However, Air Canada will continue to struggle unless passenger demand eventually picks back up. Therefore, Air Canada is not necessarily the best pick if you are trying to invest based on the thesis that we are in a new normal of consistently higher cargo and e-commerce volumes.

Takeaway

It may not be too late to buy cargo-focussed stocks. If you think the rise in e-commerce volumes will be permanent, stocks like Cargojet should still have a lot of room to run. If you think that shopping and consumption trends will revert to the pre-2020 "normal", then CN or Air Canada are probably the better buys currently.

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3. TSX:CJT (Cargojet Inc.)
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