CN Rail posts strong Q3 earnings as safety concerns weigh on railway

SCOTT DEVEAU | 22/10/13 | Last Updated: 22/10/13 6:48 PM ET **Financial Post**

Canadian National Railway Co. delivered blockbuster third-quarter earnings Tuesday driven by its growing crude-by-rail business.

The country's largest railway moved to reward shareholders with record revenue during the quarter by announcing a two-for-one stock split effective Nov. 29 in a special stock dividend, and a new share buyback program aimed at repurchasing up to 15 million, or 4.1% of its outstanding common shares, over the next year.

CN said its fourth-quarter dividend was halved to 21.5¢ a share to reflect the split.

"Clearly the solid [third quarter results] show we are gaining momentum," said Claude Mongeau, CN chief executive, on a conference call. "We're entering [the fourth quarter] with the hope of finishing strongly."

But the gains come at a time when concerns are mounting about the rapid increase in crude and other hazardous goods being shipped by rail across the country after the Lac-Mégantic disaster in July and another CN crude train derailment over the weekend.

"Obviously, we do have accidents from time to time. We had a serious one this weekend with fire involving propane cars in Alberta," Mr. Mongeau said.

Early Saturday, 13 rail cars on a westbound CN train derailed outside of Gainsford, Alb.

Nine of the cars were carrying crude oil, while four others were carrying liquefied petroleum gas, three of which caught fire and led to the evacuation of the surrounding communities.

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Mr. Mongeau noted CN had only 1.3 accidents per million train miles travelled during the quarter, a 43% improvement year-over-year for the quarter.

The incident was, however, one of three high-profile derailments in the last month for the company, and followed on the heels of several others by its smaller rival, Canadian Pacific Railway Ltd., in early 2013.

Those incidents paled in comparison to the runway Montreal, Maine and Atlantic Railway crude train that derailed in Lac-Mégantic in July killing 47 people.

All of these incidents have shone the spotlight on whether there are adequate safeguards in place as more crude is moved by rail and Canada and the U.S. debate building further pipeline capacity, including Keystone XL.

The benefits of moving crude by rail are clear for the railways.

CN reported a net income of $705 million, or $1.67 per diluted share for the third quarter, up 6% from a year ago when it reported earnings of $664 million, or $1.52 per diluted share, aided by a rapid rise in its petroleum shipments.

Analysts had been expecting earnings of $1.62 a share, according to Bloomberg estimates.

Revenue rose 8% during the quarter to a record $2.7-billion as revenue for petroleum and chemicals rose by 17%, intermodal sales jumped 13%, and metals and minerals rose 11%.

But a report issued Tuesday by the Canadian Centre for Policy Alternatives questioned whether there were adequate safeguards in place to guard against disasters.

The report faults the federal government for its “laissez-faire” attitude toward rail safety, including allowing the railroads to set their own safety procedures before they are approved by Ottawa.

The report noted that the recent run of derailments come on the backdrop of a "wild-west boom" in unconventional oil production, including shale oil from North Dakota and bitumen from Alberta.

The report notes that 270,000 barrels a day were shipped by rail in Canada on average last year, up from virtually none in 2009. Despite that rapid growth, the ranks of Transport Canada's Dangerous Goods division have failed to keep pace with only 35 inspectors, or roughly one per 4,000 crude carloads shipped last year, down from one per 14 tank cars in 2009, it noted.

At the same time, the federal government has slashed the budget for rail safety by 19% over the past four years, including reducing the budget for the Dangerous Goods division by a million dollars to $13-million, where it is expected to remain frozen until at least 2016, the CCPA report charges.

The report argues that until Lac-Mégantic, Transport Canada was lax in adopting several Transportation Safety Board recommendations, which, among other measures, included the use of more modern tank cars and opposed the practice of leaving locomotives unlocked when unattended.

Mr. Mongeau reiterated his belief that rail is a viable alternative for moving crude and other hazardous goods, noting that more than 99% of the hazardous goods shipped by rail arrive without incident.

But the CCPA report says that misses the point.

"These soothing statistics fail take into account a Lac-Mégantic — a rare event with catastrophic consequences.Faulty risk management models have lulled the industry and regulators into a sense of complacency, downplaying the risks even as skyrocketing oil shipments increased the odds of such an accident happening."

The federal government has implemented several emergency measures in the aftermath of the Lac-Mégantic disaster and has tasked an advisory council on rail safety with coming up with regulations to address the lessons learned from the disaster in July.