



## 2 Companies Perfectly Poised for Growth

### Description

Stronger fundamentals continue to buoy Canada's oil patch, and these are not being driven solely by the crisis in Iraq and the resulting higher crude prices. Economic growth in the U.S. and stronger industrial activity in China, which recently saw its manufacturing purchasing index hit a seven-month high, also continue to drive global demand for energy and other raw materials.

#### What is the impact of this increasingly positive economic outlook?

It is this increasingly positive outlook for U.S. economic growth that has seen ratings agency Moody's [upgrade its outlook](#) for the North American rail industry to positive, particularly with crude-by-rail transport set to be the largest driver of bulk freight growth in North America, as demand for oil grows and Canada's pipelines can't keep up with the demand for crude transportation.

However, this is not only good news for crude prices or railways, but will also see greater demand for raw materials including copper, zinc, and iron ore as manufacturing picks up. This is especially true with the Chinese government continuing to target GDP growth of 7.5% for 2014 and implementing a stimulus program aimed at boosting industrial production.

Growing U.S. economic activity and rising industrial activity in China also bode well for the fortunes of ailing metals miners such as **Teck Resources** (TSX: TCK.A)(NYSE: TCK) and **Hudbay Minerals** (TSX: HMB)(NYSE: HBM). However, these developments still would not make it an industry I would choose to invest in due to overall weaker fundamentals and base metal prices forecast to remain soft for some time.

#### This major railway's revenue will grow as economic growth strengthens

The primary beneficiaries of better-than-expected U.S. economic growth and growing industrial activity in China are Canada's transnational railway companies. Both **Canadian National Railway** (TSX: CNR)(NYSE: CNI) and **Canadian Pacific Railway** (TSX: CP)(NYSE: CP) will see their revenues and bottom lines grow as demand for crude transport explodes.

This is because Canadian crude production is forecast to grow by 6% annually over the next

three years, further increasing transport demand, which can't be met by existing pipeline capacity due to the [pipeline crunch](#). This makes rail the next most logical and cost-effective means of transporting crude in bulk.

However, this growth in freight transportation doesn't stop with crude. Increased raw materials demand from China because of industrial activity will drive further demand from North American miners for bulk freight transport. This highlights the diverse revenue streams of both companies, but the key question for investors is this: Which is the better choice to cash in on stronger economic activity?

The most attractive choice is Canadian National, with it exhibiting strong freight growth. For the first quarter of 2014, freight revenue shot up 7% compared to the same quarter in 2013, which is significantly higher than Canadian Pacific, with its freight revenue growing an anemic 1% in the same period. This was despite operating in an environment where demand for crude by rail grew exponentially.

The single largest driver of this growth was the transportation of petroleum and chemical products, including crude, which shot up a very healthy 23% year over year, while metals and minerals grew 7%.

Canadian National is also more attractively priced than Canadian Pacific, with an enterprise value of 13 times EBITDA compared to the latter's 16 times, while its forward P/E ratio of 16 is lower than Canadian Pacific's 17. It also pays a superior dividend yield of 1.4%, which is double Canadian Pacific's 0.7%, seeing investors rewarded for their patience as the company grows its bottom line.

### **This top five bank is one of the biggest financiers in the patch**

Obviously, the majority of players in the patch with solid, low-cost production will benefit from increased economic activity, growing demand for crude, and the resulting higher crude prices. However, there are a number of other indirect players in the patch that also stand to benefit. One that stands out is one of the largest financiers of the oil sands, **Royal Bank of Canada** ([TSX: RY](#))([NYSE: RY](#)).

Capital markets is the second-largest driver of earnings for Royal Bank, accounting for 22% of its total fiscal second quarter of 2014 earnings, while 33% of capital markets earnings comes from corporate and investment banking. A key driver of earnings growth for this segment is corporate financing, as well as merger and acquisition activity, with the patch having the greatest single demand of any industry in Canada.

Therefore, any significant increase in activity in the patch, coupled with a steep increase in investor interest, will drive higher M&A and financing activity, leading to more revenue for Royal Bank's capital markets business.

Clearly, oil producers, midstream infrastructure, and service providers operating in the patch are one way to play increased economic activity, demand for crude, and higher oil prices. Sometimes it pays for investors to think outside of the box, with both companies discussed offering growth potential linked to the patch coupled with diversity across a range of industries that will benefit from better-than-expected economic growth and industrial activity.

## **CATEGORY**

1. Investing

## TICKERS GLOBAL

1. TSX:CNR (Canadian National Railway Company)
2. TSX:CP (Canadian Pacific Railway)
3. TSX:HBM (Hudbay Minerals Inc.)
4. TSX:RY (Royal Bank of Canada)
5. TSX:TECK.B (Teck Resources Limited)

### Category

1. Investing

### Date

2025/09/04

### Date Created

2014/06/27

### Author

mattdsmith

default watermark

default watermark