Which Should You Buy: Canadian National Railway Company or Canadian Pacific Railway Limited?

Description

If you're looking for great companies to own in Canada, you may struggle. For all its blessings, Canada's largest companies tend to be very cyclical and risky. Much of our country's major stock market index is in financial services, energy, or materials — all sectors where things can go wrong in a hurry.

However, the rails are one area where you can find two top-quality companies: **Canadian National Railway Company** (TSX: CNR)(NYSE: CNI) and **Canadian Pacific Railway Limited** (TSX: CP)(NYSE: CP). These firms face limited competition and enjoy overwhelmingly high barriers to entry.

Which one is better for your portfolio?

The case for Canadian National

There's a strong case to be made for Canadian National. First of all, it has easily the best track record (no pun intended) of any rail company in North America. Its expenses as a percentage of revenue are the lowest in the industry, at an average of only 63.3% over the past three years.

Better yet, it arguably has the best track network in the industry, which spans across Canada and down to the United States Gulf Coast. In fact, it is the only railway with a track network that reaches all three coasts. Furthermore, thanks to its acquisition of EJ&E Railway in early 2009, the company is able to sidestep the congested Chicago area.

This track network is especially helpful when shipping crude by rail. Because tank cars remain in short supply, energy companies want to use them as efficiently as possible — and nothing can be more efficient than hiring one railway to take tank cars to any coast without any need for switching to another carrier. Also, the ability to sidestep Chicago is a big bonus. Thus, the rail company is very well positioned to take market share in this market.

The only knock on Canadian National is its price, which trades at over 22 times earnings. However, for such a quality company, that may not be too expensive.

The case for Canadian Pacific

Canadian Pacific's history is a much different story. For years, this railroad was the industry's worst performer by practically any measure. Expenses were stuck above 80% of revenue. Then, activist investor Bill Ackman stepped in, buying a big stake in the company and then leading a revolt against its board. The most significant result was a new CEO, Hunter Harrison. Mr. Harrison had been instrumental in leading Canadian National to prominence, and was now set to do the same at Canadian Pacific.

Mr. Harrison has dramatically reduced costs at the railway thus far, making it much more efficient. Last year, the expense ratio dropped 7.1 percentage points to 69.9%, a record for the company.

At this point, an investment in Canadian Pacific is really a bet on Mr. Harrison's continued success at the company. If he can reduce expenses down to its rival's levels, that would help boost earnings even more — and a bet on Mr. Harrison is usually a winning one.

The verdict

There is a major problem with an investment in Canadian Pacific: the stock price. At $217 per share, it trades at over 30 times earnings. This stock price is well above Mr. Ackman's initial projections, and he has been selling down his stake.

Thus, at this point, Canadian National is the better option. It has a more consistent history, a better network, and a cheaper stock price.

CATEGORY

1. Investing

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1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:CP (Canadian Pacific Railway)
3. TSX:CNR (Canadian National Railway Company)
4. TSX:CP (Canadian Pacific Railway)

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