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

Description

Railroad companies are great stocks to own. The barrier to entry is high, they are constantly shipping materials, and in comparison to trucking, it's relatively low cost. Thanks to physics, once the object is in motion, it only requires some energy to keep that momentum active.

But despite this, I am pretty bearish about railroad companies. **Canadian National Railway Company** (TSX: CNI)(NYSE: CNR) and **Canadian Pacific Railway Limited** (TSX: CP)(NYSE: CP) are the two largest railroad companies in Canada. Canadian National has a large foothold in the United States and Canadian Pacific has just promised to double earnings by 2018.

For all intents and purposes, both companies seem to be really solid buys. But I am uncertain about them right now due to two specific reasons.

1. The global economy is weakening

According to Christine Lagarde, the head of the International Monetary Fund, the global economy is still in for a lot of struggle. Predictions are that 2015 will only have a small pickup in growth. In other words, the economy is not doing that great. Furthermore, it appears that the Chinese economy is slowing, which can have significant ramifications on the world as a whole.

All of this is dangerous because railroad companies depend on a strong global economy. A railroad makes money by shipping goods. If more goods are being purchased, the railroads have to ship more of them. When the economy weakens, fewer goods are needed and therefore the railroads start to lag.

How can a company like Canadian Pacific Railway expect to double its earnings if the economy is slowing down?

2. These stocks are already expensive

Even if the economy doesn't slow down — and it really might not — then there's the simple fact that both of these companies trade above the railroad sector's 19.90 average trailing P/E. Canadian

National Railway Company has a P/E of 23.49 and Canadian Pacific Railway has a P/E of 41.39.

With the average being 19.90, that would lead me to believe that these stocks are already valued at a higher rate than the average for this sector. While the P/E of Canadian National Railway is not that much higher than the average, Canadian Pacific Railway is out of this world.

Frankly, these stocks are probably a bit overvalued and that leaves me bearish on them.

But if you want to buy one…

If I am wrong about the economy and you do decide to load up on a railroad company, my advice would be to buy Canadian National Railway Company. With their P/E at 23.49 and the company having lost 10% of its value over the past few weeks, the price is becoming more reasonable. But the other reason I suggest that is because Canadian Pacific is just too overpriced. While it's currently the "hot" railroad stock, I don't see it successfully doubling revenue by 2018.

As long as the economy doesn't collapse, I would say that a good price for Canadian National Railway is right around the $60 mark. That would drop the P/E below the sector average and then I'd feel comfortable loading up.

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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