Canadian Pacific Railway Limited vs. Canadian National Railway Company: Which Is the Safest Investment?

Description

Canadian Pacific Railway Limited (TSX: CP)(NYSE: CP) and **Canadian National Railway Company** (TSX: CNR)(NYSE: CNI) have done well in the past three years, and many investors may be wondering if the recent pullback in the shares offers a good opportunity to start a position.

Let's take a look at both companies to see how things are shaping up for 2015.

Canadian Pacific Railway

Since taking over as CEO of Canadian Pacific in 2012, Hunter Harrison has done a great job of improving efficiency at the railway. In the Q3 2014 earnings statement, Canadian Pacific reported an operating ratio of 62.8%, a record low. The metric is an important measure of how much it costs the railway to add extra revenue. Harrison told analysts in late 2012 that he wanted to get the operating ratio below 70% by 2016.

Canadian Pacific also reported strong Q3 earnings from domestic intermodal customers as well as higher revenue from the transport of crude oil. Overall net income for the third quarter hit $400 million, a 26% increase compared to the third quarter of 2013.

In early October, Canadian Pacific outlined a strategy to drive earnings much higher by 2018. A core part of the plan is to add as many as 50 cars to some train routes and increase the average speed of the trains by 20%.

Canadian Pacific trades at 33 times earnings.

Canadian National Railway

Canadian National is the only North American rail company that can offer its customers access to three coasts. This is an attractive proposition for international intermodal customers that need to move product from the ports to their inland destinations.

Canadian National has invested heavily in its intermodal infrastructure and now operates more than 20 hubs that provide quick access to major markets throughout the U.S. and Canada.

Canadian National also reported strong earnings for the third quarter. Net income rose by 21% over Q3 2103 to hit $853 million. Most of the company's transport divisions delivered solid growth, including strong demand from energy clients for crude and sand transport.

Canadian National maintained its leadership position as North America's most efficient railway with an operating ratio of 58.8% in the third quarter.

Canadian National Railway trades at 21 times earnings.

Challenges coming in 2015

The drop in oil prices will affect producers in the high-cost shale plays and this could hit demand for Canadian National's revenues on sand deliveries. Sand is a core component in the hydraulic fracturing process.

Lower oil prices also mean lower diesel costs for trucking companies. This could affect the intermodal business of both Canadian Pacific and Canadian National, as the high cost of fuel is one of the reasons the railways have been able to steal business from long-haul truckers.

Regulations targeted at reducing train speeds and improving oil car safety could also have a significant impact on earnings in 2015 and beyond as these measures would reduce efficiency and squeeze margins.

Should you buy?

Some serious headwinds could hit both companies in the next two years, especially if oil prices settle below $60 per barrel. As a long-term investment, both companies are solid bets but you might want to wait until the current volatility in the market settles down.

Canadian National trades at a more attractive price-to-earnings ratio. It is a more efficient company and has a strong competitive advantage with its network coverage across the U.S. and Canada.

The railways are good long-term holdings but the near-term risks might be too much for some investors. If you are looking for a few top picks to add to the portfolio in 2015, the following free report is worth reading.

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aswalker