



The Stock Picker's Guide to Canadian National Railway Company and Canadian Pacific Railway Limited for 2015

Description

It's been a wonderful run for shareholders of **Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)) and **Canadian Pacific Railway Limited** ([TSX:CP](#))([NYSE:CP](#)). Since the beginning of 2009, CN Rail shares have more than tripled in value (not including dividends). CP Rail shareholders have fared even better, with the shares up more than 400% over the same time period. That said, both stocks have slumped since late November, each down about 8%.

So what does 2015 hold for these companies? Will the good times continue? Should you buy either stock? Below we take a look.

A wonderful run

Since the beginning of 2009, seemingly everything has gone right for the railroads. First of all, North America experienced a broad economic recovery, which was a positive for both volumes and pricing. There was also astronomical growth in the crude-by-rail business – about 4,000% growth from 2008 to 2014. And both of the railroads were able to improve productivity significantly.

This last point was especially relevant at CP, which four years ago was the continent's most inefficient railroad. But new CEO Hunter Harrison has been able to turn the company around – operating expenses now total just 63% of revenue, down from 81% in 2011. This is why the company has seen even greater gains than CN has.

Concerns about crude by rail

There's a reason why the railroads' shares have sunk since late November – this is when the oil price slump accelerated. The oil price slump is bad news for the rails for two reasons.

First, low oil prices could lead to reduced investment in crude production. And this would lead to lower revenue from crude-by-rail, a key source of growth. Secondly, lower oil prices could help trucking become much more competitive.

Still too expensive

At this point, both companies have very expensive stocks. At nearly \$80 per share, CN is trading at nearly 22 times earnings. CP is even more expensive, trading at over 30 times earnings.

Making matters worse, these companies need to spend lots of cash just to keep their businesses going – for example, track needs upgrading and locomotives need replacing. This makes less money available for growth or big dividends.

Both companies have a lot going their way. CN Rail is enjoying record earnings, and its track network is second to none in the industry. Meanwhile, CP has reached its targets two years ahead of schedule, and Mr. Harrison hopes to double earnings over the next four years.

But these stocks are still far too expensive at current prices. For that reason, big stock gains are unlikely, even in the best of circumstances. And if the growth story falters – perhaps due to a continued fall in oil prices – either stock could fall a lot further. You're better off avoiding the shares.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
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3. TSX:CNR (Canadian National Railway Company)
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Author

bensinclair

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