Do Canada's Major Railways Make Good Dividend Stocks?

Description

When building a portfolio of dividend stocks, it's very important to choose companies with sustainable business models. After all, the whole point of dividend investing is to sit back and collect those regular payments without having to closely monitor your portfolio.

And no Canadian businesses are more sustainable than the two major railroads, **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP). These two companies each have a track network that can't be replicated, ensuring that no new direct competitors will ever emerge. Better yet, demand will always be strong, as long as we all need goods shipped.

So, does that mean dividend investors should add the rails to their portfolios? We take a look below.

Should dividend investors buy CN Rail?

There are a lot of things to like about CN Rail. It has historically been the best run of North America's major railways. It also has the best track network, the only one that reaches all three coasts (the West Coast, East Coast and Gulf Coast). CN is even able to bypass the congested Chicago area thanks to its EJ&E acquisition in 2007.

CN's numbers are also impressive. From 2011 to 2014 its revenue grew by 34%, and its net income grew by 29%. And from 2011 to today the dividend has nearly doubled.

But there's a big problem with CN's shares: they're expensive. To illustrate, the company made only $3.85 in earnings per share last year, and only $2.53 per share in free cash flow. Yet the stock trades for more than $70. As a result, the dividend yields only 1.7%.

Making matters worse, the fall in oil prices means growth will be harder to come by. Not only will crude-by-rail volumes suffer (i.e. not grow as quickly), but trucking becomes more competitive on some routes as fuel prices drop.

So, even though there's plenty to like about CN, it's just too expensive for dividend investors at this point.

Should dividend investors buy CP?

CP has accomplished a lot under CEO Hunter Harrison, and investors have been rewarded handsomely for his efforts. But CP would make an even worse dividend stock than CN for a number of reasons.

To start, CP does not have the same track network as CN. CP’s network only reaches one coast, and also runs through Chicago. So, the company cannot ship goods as far as CN can, nor can it ship as quickly.

Secondly, CP is very expensive. Last year, the company made about $8.50 per share in net income, and less than $4 per share in free cash flow. These are not high numbers for a stock trading above $200, so it’s no wonder the dividend yields less than 1%. And like CN, CP is not helped by falling crude prices.

At this point, dividend investors should certainly keep an eye on CN and CP because they are great companies. But with such expensive prices, they shouldn’t be a part of your portfolio.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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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