



4 Reasons to Buy Canadian National Railway Company Instead of Canadian Pacific Railway Limited

Description

Most investors are aware that railway stocks are fantastic investments—they possess wide economic moats and have limited competition because any new competitors face nearly impossible barriers to entry. On top of this, rails are also the lowest-cost land-transportation option.

Both **Canadian Pacific Railway Limited** ([TSX:CP](#))([NYSE:CP](#)) and **Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)) have outperformed the TSX over the past five years, but recent headwinds, like a weak economy and falling commodity prices, have made 2015 a tough year.

With a challenging macro-environment for rails, picking the right rail stock will be extremely important going forward. Here are four reasons why CN's business mix and unique rail network makes it a better buy than CP today.

1. Less exposure to coal

Declining coal volumes have been the biggest headwind for all North American rails in 2015. Thermal coal, used in power plants, has experienced steadily falling demand as more power plants switch to cheaper and cleaner natural gas. Metallurgical coal, used in steel-making and primarily imported by China, has experienced declining production as demand from China slows and the market remains oversupplied.

These are not temporary trends, and CN has an advantage here because only 5% of its revenues come from coal, as opposed to 10% for CP.

2. Stronger exposure to the U.S. economy

Currently, CP gets about 3% of revenues from forest products, compared to 13% for CN, which also happens to be the highest forest products exposure in the rail sector. Why is this important? Because CN's forestry shipments of lumber and panels are primarily destined for the U.S.

The demand for these products is largely driven by new single family housing construction, and CN's volumes increase with U.S. housing starts. This gives CN deep exposure to the U.S. economy that CP doesn't have, which is largely a result of CN's rail network, which extends directly to the Gulf Coast, whereas CP's stops south of Chicago.

U.S. GDP growth is expected to be stronger than Canada's, and U.S. unemployment is at an eight-year low, which is in turn driving strong growth in U.S. housing starts. Greater exposure to the U.S. economy will give CN a competitive edge.

3. CN has an advantage in domestic intermodal

Intermodal refers to the transportation of a single container of consumer goods across several modes of transport (truck, rail, or ship). CN gets about 23% of revenues from intermodal, and CP gets about 21%. While the segments are close in terms of revenue contribution, CN has some major advantages.

Intermodal revenues are divided into domestic and international segments. The domestic segment ships across Canada and cross-border, and the international segment moves imports and exports to and from shipping ports. On the domestic front, CN benefits from a stronger cross-border business, which once again gives it more exposure to the U.S. economy, specifically the consumer goods market.

About 25% of CN's business is to and from the U.S. and Mexico, as opposed to 14% of CP's domestic intermodal business. In addition, CN recently formed a partnership with J.B. Hunt Transport Services—the largest U.S. intermodal marketing company—and this will expand the number of U.S. markets that CN can reach, which will serve as a growth avenue for CN's cross-border business.

4. CN has an even stronger advantage in international intermodal

CN's true strength lies in its international intermodal segment, which will add significantly to growth. Currently, about 62% of CN's intermodal revenue comes from the international segment, compared to 43% for CP.

CN's strength flows from its rail network, which accesses the west coast, the east coast, and the Gulf of Mexico. Through this, CN currently has access to five separate ports as opposed to three for CP, and CN is the primary service provider for 16 of the 19 shipping lines that call at Canadian ports.

Customers understand the advantages of CN's intermodal business. In 2013 CN won three major intermodal contracts from CP. These included container lines MOL, APL, and OOCL. Some analysts suspect CN's superior geographic reach was a reason behind the switch.

With the Ports of Vancouver, Prince Rupert, and New Orleans undergoing major capacity expansions, CN is poised to see major growth in this area.

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