



3 Canadian Stocks Warren Buffett Would Consider

Description

Warren Buffett's investing success can be traced to his ability to identify companies with competitive advantages that are sustainable over long periods of time. These advantages allow such companies to generate predictable earnings growth and above-average returns on capital.

He cleverly called these sorts of competitive advantages economic moats, and being able to identify companies that have them is a key part of being a successful long-term investor. While economic moats may be few and far between in Canada's commodity-driven economy, there are a few names that certainly fit the bill.

Canadian National Railway Company ([TSX:CNR](#))([NYSE:CNI](#)), **Enbridge Inc.** ([TSX:ENB](#))([NYSE:ENB](#)), and **Potash Corporation of Saskatchewan Inc.** ([TSX:POT](#))([NYSE:POT](#)) all have wide and sustainable moats that should lead to excellent long-term returns.

Enbridge's regulated assets and existing network gives it an economic moat

Enbridge currently operates the world's longest crude oil and liquids pipeline, transporting 53% of U.S.-bound Canadian production. Enbridge's competitive advantage comes from the fact that a large portion of revenues come from regulated cost-of-service contracts.

Because some pipeline assets represent the only way for crude to travel via pipeline between two points, government agencies need to regulate the tolls on the pipeline, so monopoly prices are not charged.

In Enbridge's case, tolls are largely set on a cost-of-service basis, which means that Enbridge receives a toll that not only offsets its operating costs and cost of capital, but also guarantees a return on equity usually over 10%. Not only does regulation guarantee a return above the cost of capital, but it also locks out potential competitors, since additional pipeline capacity could reduce usage on current pipelines and lead to higher costs for shippers.

The fact that Enbridge has an extensive pipeline network also gives it a competitive advantage over its peers in terms of executing its growth strategy, since Enbridge can use existing right-of-ways to build

pipeline expansions, rather than needing to fight for challenging political approvals.

These advantages mean Enbridge has predictable cash flow growth— between 2015 and 2018, the company is expecting cash flow per share to grow by a compound annual growth rate between 15% and 18%.

Canadian National Railway has the widest moat in a wide-moat industry

Like pipelines, railways have a built-in economic moat. Railways are incredibly expensive to build, which locks out potential competitors. However, the cost is perhaps the least-daunting barrier preventing would-be competitors; in order to build a rail across a continent (like CN has), the builder would need to obtain a right-of-way, which would likely be impossible given that rails already exist.

In addition, railways have several key advantages over other long-haul forms of transport, like trucking. Railways have quadruple the fuel efficiency of trucks, and shipping the same containers via rail is about 10-30% cheaper than truck. When it comes to shipping bulk commodities (like coal or grain), there is virtually no alternative to rail.

The rail industry as a whole has durable competitive advantages, and CN Rail is best in class within the industry. CN has a rail network that spans all three coasts (its closest competitor, CP Rail, only runs east to west), and this has been key in helping CN win several major contracts.

In addition, CN is also the most efficient and one of the fastest railways, which helps differentiate it further from its peers.

Potash Corp. controls 20% of global potash capacity

Potash Corp.'s economic moat is not as wide as CN's or Enbridge's, but it is certainly worth mentioning. Potash fertilizer is not widely available globally—reserves are concentrated in a few geographic areas. As a result, production is controlled by a small handful of producers.

Potash Corp. is the largest of these producers, controlling 20% of current global capacity, and its capital projects will comprise about 50% of the new capacity coming online in the near future. The fact that Potash Corp. and a small group of producers control production means that production can be controlled to support prices.

While there are some signs this competitive advantage is changing due to eastern European producers producing near full capacity to gain market share, Potash Corp. will likely always remain the dominant producer of potash.

CATEGORY

1. Investing
2. Metals and Mining Stocks

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:ENB (Enbridge Inc.)
3. TSX:CNR (Canadian National Railway Company)
4. TSX:ENB (Enbridge Inc.)

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Author

amancini

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