



## 2 Big Benefits to Owning Canadian National Railway Company Instead of Canadian Pacific Railway Limited

### Description

There's no doubt about it—**Canadian Pacific Railway Limited** ([TSX:CP](#))([NYSE:CP](#)) was a better investment than **Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)) up until the beginning of this year. While CN has been no slouch—effectively doubling its share price between 2012 and the start of this year—CP managed to triple its price over the same period.

CP's incredible performance has been due to the fact that it has been a turnaround story, led by veteran railroader Hunter Harrison. In a few short years Harrison managed to reduce CP's operating ratio (costs as a percentage of revenues) from the industry's worst of 82% to last quarter's result of 59%.

Looking at this year, however, CP shares are down 22%, whereas CN has fared the best of any railroad, falling only 8%. With the bulk of fat already cut from CP, CP must now focus on increasing revenues to drive growth. Within the current weak economic environment, this is an area CN should excel in over CP, and combining this with an excellent shareholder-return program should give CN shareholders an edge over CP shareholders going forward.

### 1. CN should excel at driving top-line growth

CP's ability to outperform CN in earnings over the past several years has been due to CP significantly reducing costs as well as making itself more productive. CN did not have the ability to reduce costs as significantly since it is already the most efficient and cost-effective railroad in North America with an operating ratio last quarter of 53%.

In fact, from the end of 2011 to the end of 2014, CN grew its top line by 34%, whereas CP grew its top line by 27%. Going forward, there is potential for CN to continue to outperform CP in the revenue department, and the current weak economic climate should only enhance this outperformance.

This is because CN is highly exposed to consumer spending (especially U.S. consumer spending) through its large intermodal segment, whereas CP is primarily a bulk-focused railroad—transporting

goods like grain, potash, and coal.

While CN's intermodal segment is only slightly larger than CP's, CN has several key competitive advantages that should not only allow it to benefit from volume growth due to an area of the economy that is growing (consumer spending), but also potentially allow it to take market share from CP.

CN has superior geographic reach with a network that extends east and west as well as south to the Gulf Coast. In addition, CN has the fastest-train velocity in the industry, the shortest terminal dwell, as well as the fastest route through the key Chicago region. CN is also the main provider to 16 of the 19 shipping lines that call at Canadian ports.

The end result? CN should see top-line growth that exceeds CP, perhaps at CP's expense. Analysts seem to agree—**RBC** forecasts that CP will grow its revenue by 5% in 2016 compared to 12.8% for CN. RBC also learned that 67% of customers switching providers in 2016 will be switching from CP to CN.

## **2. CN offers an excellent capital-return program**

CN is expecting double-digit earnings growth, and this is only enhanced by a capital-return program that far exceeds CP's. Currently, CN has a dividend yield that is over double CP's (1.8% vs. 0.81%), and CN also as an active objective to increase this dividend over time by increasing their payout ratio.

Currently, CN has a payout ratio of about 28%, but has recently reiterated its goal of increasing this payout ratio to 35% over the next few years. CP has a payout ratio of about 14%, and has no plans to grow its dividend. In fact, CP's dividend has been frozen since 2012.

For CN shareholders, a growing payout ratio coupled with earnings that are growing at a double-digit rate should greatly complement total shareholder returns over time. In addition to this, CN also has a strong share-buyback program in place, which it just renewed for another year; it also increased it by 18% from last year. This is not a one-year program for CN, and CN has been actively buying back shares since 2000.

## **CATEGORY**

1. Investing

## **TICKERS GLOBAL**

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:CP (Canadian Pacific Railway)
3. TSX:CNR (Canadian National Railway Company)
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