Should Investors Buy Canadian National Railway Company or Canadian Pacific Railway Limited?

Description

In Canada there are two predominant railroad companies that are available for investors to buy. While Warren Buffett believes railroads are great stocks, I am of the opinion that not all railroads are created equal. When it comes to comparing **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP), I believe only one of them is truly worth buying.

To make that decision, we need to analyze a few different variables.

Operating ratio

One of the very first things I look at in railroads is the operating ratio. This is a testament to how well the company is run and how much money it can earn per one dollar invested.

According to CP's full-year report, it was able to get its operating ratio to 61%. This is an incredible improvement compared with where the company was a few years ago. On the other hand, CN remains the most efficient railroad in North America with an operating ratio of 57.2%. This nearly 4% difference can make a huge difference for a railroad.

For context, the industry median is 63.4%, so CP is still more efficient than many railroads.

Type of cargo & geographies

When Canada's economy was roaring with oil prices over $100 a barrel, CP could do no wrong. In the beginning of 2012 it was trading around $69 a share. By the beginning of January 2015, the price had skyrocketed to nearly $250 a share because commodities were doing amazingly well and CP derives the bulk of its revenue from commodities.

Now those same commodities are not doing all that well, which has put a significant burden on the company. With commodities down, less is being shipped, so the company is experiencing difficulty generating its significant margins.

On the other hand, CN derives a significant amount of revenue from the United States. This helps two ways: when that revenue comes back to Canada, the conversion results in more CAD earned, and a weak Canadian dollar results in an increase in forestry and automotive goods.

While both companies certainly suffer from the drop in commodities, CN is more diverse from a geographic perspective and from the type of cargo that it carries.

Returning money to investors

Both companies return money to investors in a generous fashion. On the dividend end, CN pays out a yield of 1.91%, which comes out to $0.38 per quarter. Further, the company has been significantly increasing its dividend. At the end of its last fiscal year, it announced a 20% increase to the dividend. Every year since it went public in 1995, the dividend has increased by 17% on average. Until the payout ratio is equal to about 35%, this dividend is going to keep rising.

CP, on the other hand, doesn't pay very much in dividends. Its 0.86% yield results in $0.35 per quarter.

But where both companies shine is in the share-buyback programs. CP bought back $2.75 billion in fiscal 2015, and it is likely to continue buying shares in 2016, especially as the shares remain depressed. CN has been reducing its total shares since 2000, but has seen acceleration for the past few years. In 2013 it spent $1.4 billion; in 2014 it spent $1.51 billion; and it spent $1.75 billion in 2015. I expect that to continue in 2016.

All told, railroad stocks are great buys. But while CP is better priced than it once was, I would buy CN. It's more efficient, has fewer headwinds, and is a dividend-growth stock, making this stock worth buying.

CATEGORY

1. Investing

TICKERS GLOBAL

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3. TSX:CNR (Canadian National Railway Company)
4. TSX:CP (Canadian Pacific Railway)

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