Are Canada’s Top Railroads on Sale?

Description

The less we pay for a stock, the more value we get. However, this only works if we stick to the top companies. Investors are lucky today because the Canadian railroad leaders, **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) and **Canadian Pacific Railway Limited** (TSX:CP)(NYSE:CP), have dipped 12% and 29%, respectively, from their 2015 highs.

In the past decade, Canadian Pacific and Canadian National delivered annualized returns of 12.2% and 13.6%, respectively, while the S&P 500 returned 5.6%.

With a history of outperformance, it makes sense to consider the top Canadian railroads when their shares are down, but which is a better buy today?

Which is a better value today?

Initially, it seems Canadian National is cheaper because it trades at about $77 per share, while Canadian Pacific trades at about $168 per share. However, it’s not meaningful to compare the price per share of two companies.

When looking at their price-to-earnings multiples, Canadian Pacific is actually cheaper. It trades at about 16.2 times its earnings, while Canadian National trades at about 17.2 times its earnings.

In 2015, Canadian Pacific grew its earnings per share (EPS) by 19%. Its EPS growth is expected to slow to about 13% per year in the medium term. This is partly why its multiple contracted and its shares fell.

In 2015, Canadian National grew its EPS by 18%. Its medium-term EPS growth is expected to slow to about 8% per year.

Comparing their valuations and earnings growth potential, Canadian Pacific is a better value today.

Profitability

However, you might wonder why Canadian National is trading at a premium despite its expected slower growth. Canadian National has a stronger profitability track record. It has achieved a return on equity (ROE) of over 17% every year in the past 10 years, while Canadian Pacific has only achieved an ROE of more than 10% every year in the same period.

However, Canadian Pacific seems to be catching up. In the last two years, it has achieved a strong ROE of 23-26%. If the railroad can keep this up with its competitive operating margin of 41%, it will be a better value today.

Comparatively, Canadian National has achieved an ROE of 24-25% in the past two years. And in the first quarter, its operating margin was also 41%.

Conclusion

Canadian Pacific is a cheaper investment than Canadian National today. However, there’s no need to rush to buy it.

In the near term, Canadian Pacific’s share price isn’t likely to go anywhere due to slower demand in grain, coal, and fertilizers, which made up about 44% of its 2015 freight revenues. However, in the long term, economic growth will eventually pick up again.

When it does, its multiple will expand. Even if Canadian Pacific Railway’s multiple only remains constant at 16.2, it can still deliver annualized returns of about 13% if its medium-term earnings growth estimate materializes.

A 13% annualized return is 3-6% higher than the average market returns. For an investment of $10,000, it would give an extra return of $1,592-3,382 in five years.

CATEGORY

1. Dividend Stocks
2. 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)

Category

1. Dividend Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/08/24
Date Created
2016/05/25
Author
kayng