



Canadian Pacific Railway Limited Versus Canadian National Railway Company

Description

Following quarterly earnings reports, Bernstein Research has updated its views on the railroad industry.

Canadian Pacific Railway Limited ([TSX:CP](#))([NYSE:CP](#)) was kept at outperform with a \$171 price target, while **Canadian National Railway Company** ([TSX:CNR](#))([NYSE:CNI](#)) was maintained at just market perform with a \$68 price target.

Today, Bernstein seems to think Canadian Pacific has roughly double the upside compared to Canadian National.

Why does the research company feel so optimistic about Canadian Pacific? Should you follow their advice?

Volumes are under siege

One observation that Bernstein Research has right is that rail volumes are under incredible pressure. While aggressive cost-cutting in the sector has helped to make up for some of the declines, the rail industry is clearly less lucrative than it was just 18 months ago.

The macroeconomic conditions for Canada look especially tough. Growth has slowed considerably as the country grapples with a volatile housing market, plummeting energy prices, and sky-high consumer debt levels.

On November 1, Statistics Canada revealed that Canadian economic growth continues to slow. August GDP growth came in at 0.2%, while July's growth was revised lower to 0.4% from its previously reported figure of 0.5%.

According to *BNN*, "The oil-oriented Canadian economy has struggled to gain sustainable momentum since it was hit by a drop in crude prices last year. Growth is seen cooling to 1.5% in the final quarter of the year."

The Bank of Canada recently cut its GDP forecast to 1.1% in 2016 and 2% in 2017. The chief

concerns were sluggish exports, slowing real estate markets, and nervousness about the U.S. election.

Canadian Pacific will feel more pain

Across nearly every commodity segment, Canadian railroads are feeling volume pressures. Canadian National executive Jean-Jacques Ruest said this year that “volume is weak, will get weaker, and pricing is not the greatest.”

“We continue to experience high volatility and weaker conditions in a number of commodity sectors,” CFO Luc Jobin said on the company’s conference call. “We’ve got our work cut out ... there are some challenges out there,” added former CEO Claude Mongeau.

Still, Canadian National's business is better positioned than Canadian Pacific's. Canadian Pacific, despite its higher current valuation, is a bit riskier when you break down its rail car traffic. A massive 42% of volumes come from bulk sources such as grain or coal with another 17% coming from metals, minerals, and crude oil.

A lower exposure to commodities has helped Canadian National generate a steadier and higher rate of return for shareholders.

Over the past few years, Canadian National has generated an average return on invested capital of about 15%. Canadian Pacific has experienced wild swings from 5% to 13%. Return on equity for Canadian National (now at 25%) has also been much more stable than that of Canadian Pacific.

With massive concerns surrounding Canada’s economy over the next few years, Canadian National is your best bet.

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)
4. TSX:CP (Canadian Pacific Railway)

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